# FOREX FUNDAMENTAL COURSE

# VOL 1

## http://pak.ifxworld.com

# Forex Fundamental Course

## What is Forex?

If you've ever traveled to another country, you usually had to find a currency exchange booth at the airport, and then exchange the money you have in your wallet (if you're a dude) or purse (if you're a lady) or man purse (if you're a metrosexual) into the currency of the country you are visiting.

You go up to the counter and notice a screen displaying different exchange rates for different currencies. You find "Japanese yen" and think to yourself, "WOW! My one dollar is worth 100 yen?! And I have ten dollars! I'm going to be rich!!!" (This excitement is quickly killed when you stop by a shop in the airport afterwards to buy a can of soda and, all of a sudden, half your money is gone.)

When you do this, you've essentially participated in the forex market! You've exchanged one currency for another. Or in forex trading terms, assuming you're an American visiting Japan, you've sold dollars and bought yen.

Before you fly back home, you stop by the currency exchange booth to exchange the yen that you miraculously have left over (Tokyo is expensive!) and notice the exchange rates have changed. It's these changes in the exchanges rates that allow you to make money in the foreign exchange market.

The foreign exchange market, which is usually known as "forex" or "FX," is the largest financial market in the world. Compared to the measly $74 billion a day volume of the New York Stock Exchange, the foreign exchange market looks absolutely ginormous with its **$4 TRILLION** a day trade volume. Forex rocks our socks!

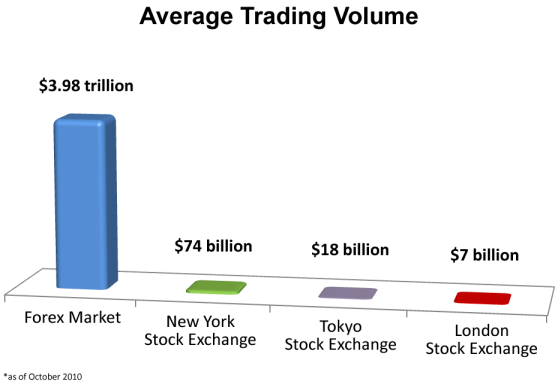
Let's take a moment to put this into perspective using monsters...

The largest stock market in the world, the New York Stock Exchange (NYSE), trades a volume of about $74 billion each day. If we used a monster to represent NYSE, it would look like this...

You hear about the NYSE in the news every day... on CNBC... on Bloomberg...on BBC... heck, you even probably hear about it at your local gym. "The NYSE is up today, blah, blah". When people talk about the "market", they usually mean the stock market. So the NYSE sounds big, it's loud and likes to make a lot of noise.

But if you actually compare it to the foreign exchange market, it would look like this...

Check out the graph of the average daily trading volume for the forex market, New York Stock Exchange, Tokyo Stock Exchange, and London Stock Exchange:




The currency market is over 53 times BIGGER! It is HUGE! But hold your horses, there's a catch!

That huge $4 trillion number covers the entire global foreign exchange market, BUT retail traders (that's us) trade the spot market and that's about $1.49 trillion. So you see, the forex market is definitely huge, but not as huge as the media would like you to believe.

Do you feel like you already know what the forex market is all about? We're just getting started! In the next section we'll reveal WHAT exactly is traded in the forex market.

# What is Traded?

The simple answer is **MONEY**.

Because you're not buying anything physical, this kind of trading can be confusing.

Think of buying a currency as buying a share in a particular country, kinda like buying stocks of a company. The price of the currency is a direct reflection of what the market thinks about the current and future health of the Japanese economy.

When you buy, say, the Japanese yen, you are basically buying a "share" in the Japanese economy. You are *betting* that the Japanese economy is doing well, and will even get better as time goes. Once you sell those "shares" back to the market, hopefully, you will end up with a profit.

**In general, the exchange rate of a currency versus other currencies is a reflection of the condition of that country's economy, compared to other countries' economies.**

By the time you graduate from this School of Pipsology, you'll be eager to start working with currencies

# Forex Fundamental Course

## *Major Currencies*

| Symbol | Country | Currency | Nickname |
|---|---|---|---|
| USD | United States | Dollar | Buck |
| EUR | Euro zone members | Euro | Fiber |
| JPY | Japan | Yen | Yen |
| GBP | Great Britain | Pound | Cable |
| CHF | Switzerland | Franc | Swissy |
| CAD | Canada | Dollar | Loonie |
| AUD | Australia | Dollar | Aussie |
| NZD | New Zealand | Dollar | Kiwi |

Currency symbols always have three letters, where the first two letters identify the name of the country and the third letter identifies the name of that country's currency.

Take NZD for instance. NZ stands for New Zealand, while D stands for dollar. Easy enough, right?

The currencies included in the chart above are called the "majors" because they are the most widely traded ones.

We'd also like to let you know that "buck" isn't the only nickname for USD.

There's also: greenbacks, bones, benjis, benjamins, cheddar, paper, loot, scrilla, cheese, bread, moolah, dead presidents, and cash money.

So, if you wanted to say, "I have to go to work now."

Instead, you could say, "Yo, I gotta bounce! Gotta make them benjis son!"

Or if you wanted to say, "I have lots of money. Let's go to the shopping mall in the evening."

Instead, why not say, ""Yo, I gots mad scrilla! Let's go rock that mall later."

Did you also know that in Peru, a nickname for the U.S. dollar is Coco, which is a pet name for Jorge (George in Spanish), a reference to the portrait of George Washington on the $1 note?

# Currencies Are Traded in Pairs

Forex trading is the simultaneous buying of one currency and selling another. Currencies are traded through a broker or dealer, and are traded in pairs; for example the euro and the U.S. dollar (EUR/USD) or the British pound and the Japanese yen (GBP/JPY).

When you trade in the forex market, you buy or sell in currency pairs.

Imagine each pair constantly in a "tug of war" with each currency on its own side of the rope. Exchange rates fluctuate based on which currency is stronger at the moment.

## *Major Currency Pairs*

The currency pairs listed below are considered the "majors". These pairs all contain the U.S. dollar (USD) on one side and are the most frequently traded. The majors are the most liquid and widely traded currency pairs in the world.

| Pair | Countries | FX Geek Speak |
|---|---|---|
| EUR/USD | Euro zone / United States | "euro dollar" |
| USD/JPY | United States / Japan | "dollar yen" |
| GBP/USD | United Kingdom / United States | "pound dollar" |
| USD/CHF | United States/ Switzerland | "dollar swissy" |
| USD/CAD | United States / Canada | "dollar loonie" |
| AUD/USD | Australia / United States | "aussie dollar" |
| NZD/USD | New Zealand / United States | "kiwi dollar" |

## *Major Cross-Currency Pairs or Minor Currency Pairs*

Currency pairs that don't contain the U.S. dollar (USD) are known as cross-currency pairs or simply as the "crosses." Major crosses are also known as "minors." The most actively traded crosses are derived from the three major non-USD currencies: EUR, JPY, and GBP.

### Euro Crosses

| Pair | Countries | FX Geek Speak |
|---|---|---|
| EUR/CHF | Euro zone / Switzerland | "euro swissy" |
| EUR/GBP | Euro zone / United Kingdom | "euro pound" |
| EUR/CAD | Euro zone / Canada | "euro loonie" |
| EUR/AUD | Euro zone / Australia | "euro aussie" |
| EUR/NZD | Euro zone / New Zealand | "euro kiwi" |

### Yen Crosses

| Pair | Countries | FX Geek Speak |
|---|---|---|
| EUR/JPY | Euro zone / Japan | "euro yen" or "yuppy" |
| GBP/JPY | United Kingdom / Japan | "pound yen" or "guppy" |
| CHF/JPY | Switzerland / Japan | "swissy yen" |
| CAD/JPY | Canada / Japan | "loonie yen" |
| AUD/JPY | Australia / Japan | "aussie yen" |
| NZD/JPY | New Zealand / Japan | "kiwi yen" |

### Pound Crosses

| Pair | Countries | FX Geek Speak |
|---|---|---|
| GBP/CHF | United Kingdom / Switzerland | "pound swissy" |
| GBP/AUD | United Kingdom / Australia | "pound aussie" |
| GBP/CAD | United Kingdom / Canada | "pound loonie" |
| GBP/NZD | United Kingdom / New Zealand | "pound kiwi" |

### Other Crosses

| Pair | Countries | FX Geek Speak |
|---|---|---|
| AUD/CHF | Australia / Switzerland | "aussie swissy" |
| AUD/CAD | Australia / Canada | "aussie loonie" |
| AUD/NZD | Australia / New Zealand | "aussie kiwi" |
| CAD/CHF | Canada / Switzerland | "loonie swissy" |
| NZD/CHF | New Zealand / Switzerland | "kiwi swissy" |
| NZD/CAD | New Zealand / Canada | "kiwi loonie" |

## *Exotic Pairs*

No, exotic pairs are not exotic belly dancers who happen to be twins. Exotic pairs are made up of one major currency paired with the currency of an emerging economy, such as Brazil, Mexico, or Hungary. The chart below contains a few examples of exotic currency pairs. Wanna take a shot at guessing what those other currency symbols stand for?

Depending on your forex broker, you may see the following exotic pairs so it's good to know what they are. Keep in mind that these pairs aren't as heavily traded as the "majors" or "crosses," so the transaction costs associated with trading these pairs are usually bigger.

| Pair | Countries | FX Geek Speak |
|---|---|---|
| USD/HKD | United States / Hong Kong | |
| USD/SGD | United States / Singapore | |
| USD/ZAR | United States / South Africa | "dollar rand" |
| USD/THB | United States / Thailand | "dollar baht" |
| USD/MXN | United States / Mexico | "dollar peso" |
| USD/DKK | United States / Denmark | "dollar krone" |
| USD/SEK | United States / Sweden | |
| USD/NOK | United States / Norway | |

It isn't unusual to see spreads that are two or three times bigger than that of EUR/USD or USD/JPY. So if you want to trade exotics pairs, remember to factor this in your decision.

# Market Size and Liquidity

Unlike other financial markets like the New York Stock Exchange, the forex spot market has neither a physical location nor a central exchange.

The forex market is considered an Over-the-Counter (OTC), or "Interbank", market due to the fact that the entire market is run electronically, within a network of banks, continuously over a 24-hour period.

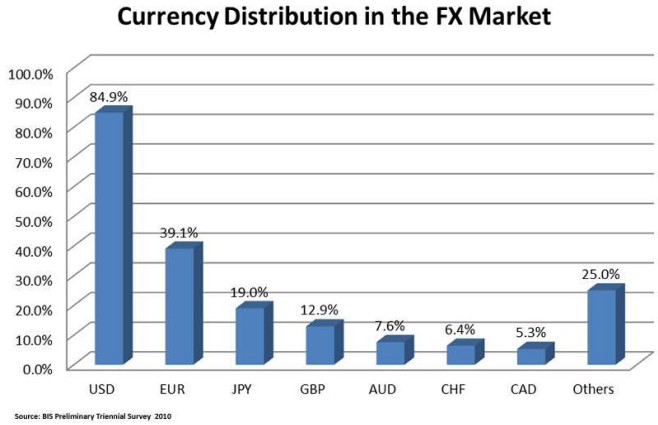
This means that the spot forex market is spread all over the globe with no central location. They can take place anywhere, even at the top of Mt. Fiji!

The forex OTC market is by far the biggest and most popular financial market in the world, traded globally by a large number of individuals and organizations.

In the OTC market, participants determine who they want to trade with depending on trading conditions, attractiveness of prices, and reputation of the trading counterpart.

The chart below shows the ten most actively traded currencies.

The dollar is the most traded currency, taking up 84.9% of all transactions. The euro's share is second at 39.1%, while that of the yen is third at 19.0%. As you can see, most of the major currencies are hogging the top spots on this list!

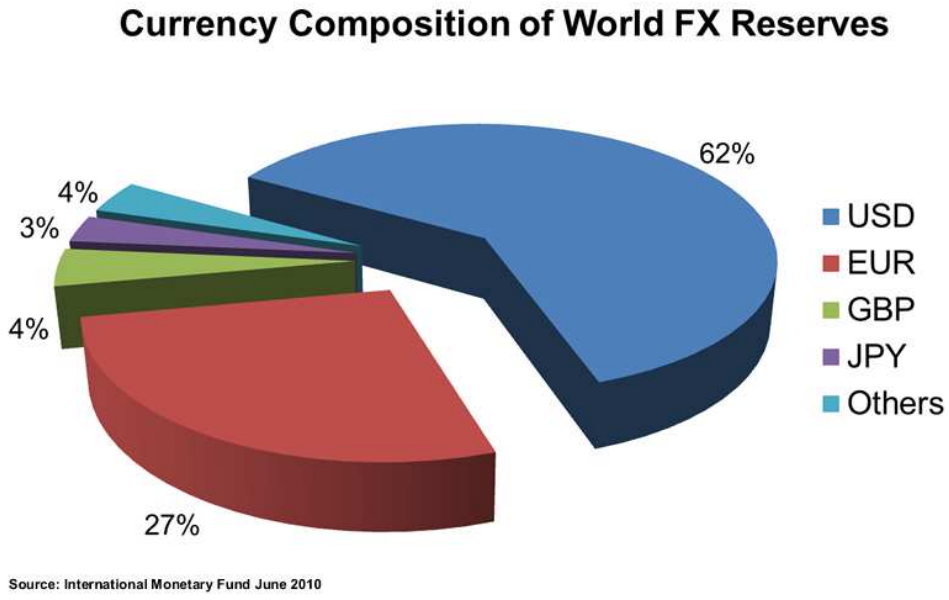



**Because two currencies are involved in each transaction, the sum of the percentage shares of individual currencies totals 200% instead of 100%*

The chart above shows just how often the U.S. dollar is traded in the forex market. It is on one side of a ridiculous 84.9% of all reported transactions!

## *The Dollar is King*

You've probably noticed how often we keep mentioning the U.S. dollar (USD). If theUSD is one half of every major currency pair, and the majors comprise 75% of all trades, then it's a must to pay attention to the U.S. dollar. The USD is king!




In fact, according to the International Monetary Fund (IMF), the U.S. dollar comprises almost 62% of the world's official foreign exchange reserves! Because almost every investor, business, and central bank own it, they pay attention to the U.S. dollar.

There are also other significant reasons why the U.S. dollar plays a central role in the forex market:

- The United States economy is the LARGEST economy in the world.
- The U.S. dollar is the reserve currency of the world.
- The United States has the largest and most liquid financial markets in the world.
- The United States has a super stable political system.
- The United States is the world's sole military superpower.
- The U.S. dollar is the medium of exchange for many cross-border transactions. For example, oil is priced in U.S. dollars. So if Mexico wants to buy oil from Saudi Arabia, it can only be bought with U.S. dollar. If Mexico doesn't have any dollars, it has to sell its pesos first and buy U.S. dollars.

## *Speculation*

One important thing to note about the forex market is that while commercial and financial transactions are part of trading volume, most currency trading is based on speculation.

In other words, most trading volume comes from traders that buy and sell based on intraday price movements.

The trading volume brought about by speculators is estimated to be more than 90%!

The scale of the forex speculative market means that liquidity - the amount of buying and selling volume happening at any given time - is extremely high.

This makes it very easy for anyone to buy and sell currencies.

From the perspective of an investor, liquidity is very important because it determines how easily price can change over a given time period. A liquid market environment like forex enables huge trading volumes to happen with very little effect on price, or price action.

While the forex market is relatively very liquid, the market depth could change depending on the currency pair and time of day.

In our trading sessions part of the school, we'll tell you how the time of your trades can affect the pair you're trading.

In the meantime, here are a few tricks on how you can trade currencies in gazillion ways. We even narrowed it down to four!

# Different Ways to Trade Forex

Because forex is so awesome, traders came up with a number of different ways to invest or speculate in currencies. Among these, the most popular ones are forex spot, futures, options, and exchange-traded funds (or ETFs).

## *Spot Market*

In the spot market, currencies are traded immediately or "on the spot," using the current market price. What's awesome about this market is its simplicity, liquidity, tight spreads, and round-the-clock operations. It's very easy to participate in this market since accounts can be opened with as little as a $25! (Not that we suggest you do) - you'll learn why in our Capitalization lesson! Aside from that, most brokers usually provide charts, news, and research for free.

## *Futures*

Futures are contracts to buy or sell a certain asset at a specified price on a future date (That's why they're called futures!). Forex futures were created by the Chicago Mercantile Exchange (CME) way back in 1972, when bell bottoms and platform boots were still in style. Since futures contracts are standardized and traded through a centralized exchange, the market is very transparent and well-regulated. This means that price and transaction information are readily available.

## *Options*

An "option" is a financial instrument that gives the buyer the right or the option, but not the obligation, to buy or sell an asset at a specified price on the option's expiration date. If a trader "sold" an option, then he or she would be obliged to buy or sell an asset at a specific price at the expiration date.

Just like futures, options are also traded on an exchange, such as the Chicago Board Options Exchange, the International Securities Exchange, or the Philadelphia Stock Exchange. However, the disadvantage in trading forex options is that market hours are limited for certain options and the liquidity is not nearly as great as the futures or spot market.

### *Exchange-traded Funds*

Exchange-traded funds or ETFs are the youngest members of the forex world.

An ETF could contain a set of stocks combined with some currencies, allowing the trader to diversify with different assets. These are created by financial institutions and can be traded like stocks through an exchange. Like forex options, the limitation in trading ETFs is that the market isn't open 24 hours. Also, since ETFs contain stocks, these are subject to trading commissions and other transaction costs.

# Advantages of Forex

There are many benefits and advantages of trading forex. Here are just a few reasons why so many people are choosing this market:

### *No commissions*

No clearing fees, no exchange fees, no government fees, no brokerage fees. Most retail brokers are compensated for their services through something called the "bid-ask spread".

### *No middlemen*

Spot currency trading eliminates the middlemen and allows you to trade directly with the market responsible for the pricing on a particular currency pair.

### *No fixed lot size*

In the futures markets, lot or contract sizes are determined by the exchanges. A standard-size contract for silver futures is 5,000 ounces. In spot forex, you determine your own lot, or position size. This allows traders to participate with accounts as small as $25 (although we'll explain later why a $25 account is a bad idea).

### *Low transaction costs*

The retail transaction cost (the bid/ask spread) is typically less than 0.1% under normal market conditions. At larger dealers, the spread could be as low as 0.07%. Of course this depends on your leverage and all will be explained later.

### *A 24-hour market*

There is no waiting for the opening bell. From the Monday morning opening in Australia to the afternoon close in New York, the forex market never sleeps. This is awesome for those who want to trade on a part-time basis, because you can choose when you want to trade: morning, noon, night, during breakfast, or in your sleep.

### *No one can corner the market*

The foreign exchange market is so huge and has so many participants that no single entity (not even a central bank or the mighty Chuck Norris himself) can control the market price for an extended period of time.

### *Leverage*

In forex trading, a small deposit can control a much larger total contract value. Leverage gives the trader the ability to make nice profits, and at the same time keep risk capital to a minimum.

For example, a forex broker may offer 50-to-1 leverage, which means that a $50 dollar margin deposit would enable a trader to buy or sell $2,500 worth of currencies. Similarly, with $500 dollars, one could trade with $25,000 dollars and so on. While this is all gravy, let's remember that leverage is a double-edged sword. Without proper risk management, this high degree of leverage can lead to large losses as well as gains.

### *High Liquidity.*

Because the forex market is so enormous, it is also extremely liquid. This means that under normal market conditions, with a click of a mouse you can instantaneously buy and sell at will as there will usually be someone in the market willing to take the other side of your trade. You are never "stuck" in a trade. You can even set your online trading platform to automatically close your position once your desired profit level (a limit order) has been reached, and/or close a trade if a trade is going against you (a stop loss order).

### *Low Barriers to Entry*

You would think that getting started as a currency trader would cost a ton of money. The fact is, when compared to trading stocks, options or futures, it doesn't. Online forex brokers offer "mini" and "micro" trading accounts, some with a minimum account deposit of $25.

We're not saying you should open an account with the bare minimum, but it does make forex trading much more accessible to the average individual who doesn't have a lot of start-up trading capital.

### *Free Stuff Everywhere!*

Most online forex brokers offer "demo" accounts to practice trading and build your skills, along with real-time forex news and charting services.

And guess what?! They're all free!

Demo accounts are very valuable resources for those who are "financially hampered" and would like to hone their trading skills with "play money" before opening a live trading account and risking real money.

Now that you know the advantages of the forex market, see how it compares with the stock market!

# Forex vs. Stocks

There are approximately 4,500 stocks listed on the New York Stock exchange. Another 3,500 are listed on the NASDAQ. Which one will you trade? Got the time to stay on top of so many companies?

In spot currency trading, there are dozens of currencies traded, but the majority of market players trade the four major pairs. Aren't four pairs much easier to keep an eye on than thousands of stocks?

That's just one of the many advantages of the forex market over the stock markets. Here are a few more:

### *24-Hour Market*

The forex market is a seamless 24-hour market. Most brokers are open from Sunday at 4:00 pm EST until Friday at 4:00 pm EST, with customer service usually available 24/7. With the ability to trade during the U.S., Asian, and European market hours, you can customize your own trading schedule.

### *Minimal or No Commissions*

Most forex brokers charge no commission or additional transactions fees to trade currencies online or over the phone. Combined with the tight, consistent, and fully transparent spread, forex trading costs are lower than those of any other market. Most brokers are compensated for their services through the bid/ask spread.

### *Instant Execution of Market Orders*

Your trades are instantly executed under normal market conditions. Under these conditions, usually the price shown when you execute your market order is the price you get. You're able to execute directly off real-time streaming prices (Oh yeeeaah! Big time!).

Keep in mind that many brokers only guarantee stop, limit, and entry orders under normal market conditions. Trading during a massive alien invasion from outer space would not fall under "normal market" conditions. Fills are instantaneous most of the time, but under extraordinarily volatile market conditions, like during Martian attacks, order execution may experience delays.

## *Short-Selling without an Uptick*

Unlike the equity market, there is no restriction on short selling in the currency market. Trading opportunities exist in the currency market regardless of whether a trader is long or short, or whichever way the market is moving. Since currency trading always involves buying one currency and selling another, there is no structural bias to the market. So you always have equal access to trade in a rising or falling market.

## *No Middlemen*

Centralized exchanges provide many advantages to the trader. However, one of the problems with any centralized exchange is the involvement of middlemen. Any party located in between the trader and the buyer or seller of the security or instrument traded will cost them money. The cost can be either in time or in fees.

Spot currency trading, on the other hand, is decentralized, which means quotes can vary from different currency dealers. Competition between them is so fierce that you are almost always assured that you get the best deals. Forex traders get quicker access and cheaper costs.

## *Buy/Sell programs do not control the market.*

How many times have you heard that "Fund A" was selling "X" or buying "Z"? The stock market is very susceptible to large fund buying and selling.

In spot trading, the massive size of the forex market makes the likelihood of any one fund or bank controlling a particular currency very small. Banks, hedge funds, governments, retail currency conversion houses, and large net worth individuals are just some of the participants in the spot currency markets where the liquidity is unprecedented.

### *Analysts and brokerage firms are less likely to influence the market*

Have you watched TV lately? Heard about a certain Internet stock and an analyst of a prestigious brokerage firm accused of keeping its recommendations, such as "buy," when the stock was rapidly declining? It is the nature of these relationships. No matter what the government does to step in and discourage this type of activity, we have not heard the last of it.

IPOs are big business for both the companies going public and the brokerage houses. Relationships are mutually beneficial and analysts work for the brokerage houses that need the companies as clients. That catch-22 will never disappear.

Foreign exchange, as the prime market, generates billions in revenue for the world's banks and is a necessity of the global markets. Analysts in foreign exchange have very little effect on exchange rates; they just analyze the forex market.

| Advantages | Forex | Stocks |
|---|---|---|
| 24-Hour Trading | YES | No |
| Minimal or no Commission | YES | No |
| Instant Execution of Market Orders | YES | No |
| Short-selling without an Uptick | YES | No |
| No Middlemen | YES | No |
| No Market Manipulation | YES | No |

It looks like the scorecard between Mr. Forex and Mr. Stocks shows a strong victory by Mr. Forex! Will it go for 2-0 with Mr. Futures?

# Forex vs. Futures

The forex market also boasts of a bunch of advantages over the futures market, similar to its advantages over stocks. But wait, there's more... So much more!

### *Liquidity*

In the forex market, $4 trillion is traded daily, making it the largest and most liquid market in the world. This market can absorb trading volume and transaction sizes that dwarf the capacity of any other market. The futures market trades a puny $30 billion per day. Thirty billion? Peanuts!

The futures markets can't compete with its relatively limited liquidity. The forex market is always liquid, meaning positions can be liquidated and stop orders executed with little or no slippage except in extremely volatile market conditions.

### *24-Hour Market*

At 5:00 pm EST Sunday, trading begins as markets open in Sydney. At 7:00 pm EST the Tokyo market opens, followed by London at 3:00 am EST. And finally, New York opens at 8:00 am EST and closes at 4:00 p.m. EST. Before New York trading closes, the Sydney market is back open - it's a 24-hour seamless market!

As a trader, this allows you to react to favorable or unfavorable news by trading immediately. If important data comes in from the United Kingdom or Japan while the U.S. futures market is closed, the next day's opening could be a wild ride. (Overnight markets in futures currency contracts exist, but they are thinly traded, not very liquid, and are difficult for the average investor to access.)

### *Minimal or no commissions*

With Electronic Communications Brokers becoming more popular and prevalent over the past couple of years, there is the chance that a broker may require you to pay commissions. But really, the commission fees are peanuts compared to what you pay in the futures market. The competition among brokers is so fierce that you will most likely get the best quotes and very low transaction costs.

### *Price Certainty*

When trading forex, you get rapid execution and price certainty under normal market conditions. In contrast, the futures and equities markets do not offer price certainty or instant trade execution. Even with the advent of electronic trading and limited guarantees of execution speed, the prices for fills for futures and equities on market orders are far from certain. The prices quoted by brokers often represent the LAST trade, not necessarily the price for which the contract will be filled.

### *Guaranteed Limited Risk*

Traders must have position limits for the purpose of risk management. This number is set relative to the money in a trader's account. Risk is minimized in the spot forex market because the online capabilities of the trading platform will automatically generate a margin call if the required margin amount exceeds the available trading capital in your account.

During normal market conditions, all open positions will be closed immediately (during fast market conditions, your position could be closed beyond your stop loss level).

In the futures market, your position may be liquidated at a loss bigger than what you had in your account, and you will be liable for any resulting deficit in the account. That sucks.

| Advantages | Forex | Futures |
|---|---|---|
| 24-Hour Trading | YES | No |
| Minimal or no Commission | YES | No |
| Up to 500:1 Leverage | YES | No |
| Price Certainty | YES | No |
| Guaranteed Limited Risk | YES | No |

Judging by the Forex vs. Futures Scorecard, Mr. Forex looks **UNBEATABLE**! Now meet the winners who trade the forex market.

# Forex Market Structure

For the sake of comparison, let us first examine a market that you are probably very familiar with: the stock market. This is how the structure of the stock market looks like:

"I have no choice but to go through a centralized exchange!"

By its very nature, the stock market tends to be very monopolistic. There is only one entity, one specialist that controls prices. All trades must go through this specialist. Because of this, prices can easily be altered to benefit the specialist, and not traders.

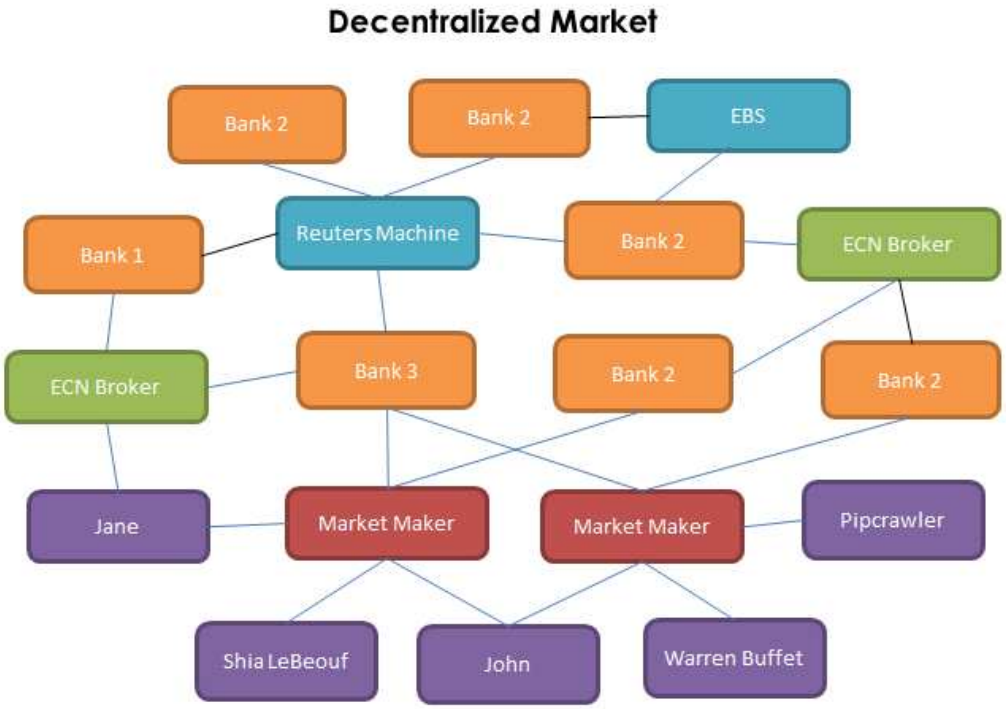
How does this happen?

In the stock market, the specialist is forced to fulfill the order of its clients. Now, let's say the number of sellers suddenly exceed the number of buyers. The specialist, which is forced to fulfill the order of its clients, the sellers in this case, is left with a bunch of stock that he cannot sell-off to the buyer side.

In order to prevent this from happening, the specialist will simply widen the spread or increase the transaction cost to prevent sellers from entering the market. In other words, the specialists can manipulate the quotes it is offering to accommodate its needs.

### *Trading Spot FX is Decentralized*

Unlike in trading stocks or futures, you don't need to go through a centralized exchange like the New York Stock Exchange with just one price. In the forex market, there is no single price that for a given currency at any time, which means quotes from different currency dealers vary.



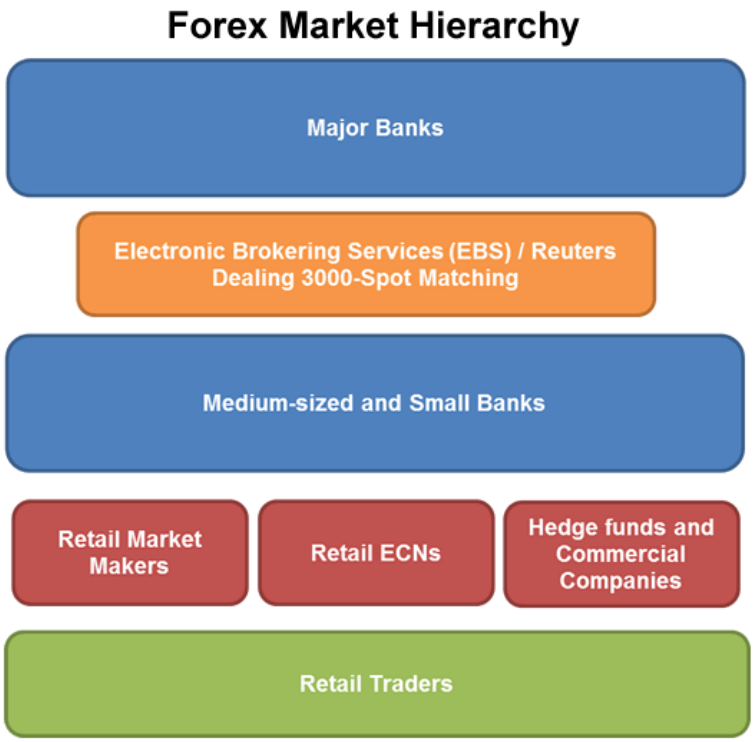

"So many choices! Awesome!"

This might be overwhelming at first, but this is what makes the forex market so freakin' awesome! The market is so huge and the competition between dealers is so fierce that you get the best deal almost every single time. And tell me, who does not want that?

Also, one cool thing about forex trading is that you can do it anywhere. It's just like trading baseball cards. You want that mint condition Mickey Mantle rookie card, so it is up to you to find the best deal out there. Your colleague might give up his Mickey Mantle card for just a Babe Ruth card, but your best friend will only part with his Mickey Mantle rookie card for your soul.

## *The FX Ladder*

Even though the forex market is decentralized, it isn't pure and utter chaos! The participants in the FX market can be organized into a ladder. To better understand what we mean, here is a neat illustration:




At the very top of the forex market ladder is the interbank market. Composed of the largest banks of the world and some smaller banks, the participants of this market trade directly with each other or electronically through the Electronic Brokering Services (EBS) or the Reuters Dealing 3000-Spot Matching.

The competition between the two companies - the EBS and the Reuters Dealing 3000-Spot Matching - is similar to Coke and Pepsi. They are in constant battle for clients and continually try to one-up each other for market share. While both companies offer most currency pairs, some currency pairs are more liquid on one than the other.

For the EBS plaform, EUR/USD, USD/JPY, EUR/JPY, EUR/CHF, and USD/CHF are more liquid. Meanwhile, for the Reuters platform, GBP/USD, EUR/GBP, USD/CAD, AUD/USD, and NZD/USD are more liquid.

All the banks that are part of the interbank market can see the rates that each other is offering, but this doesn't necessarily mean that anyone can make deals at those prices.

Like in real life, the rates will largely dependent on the established **CREDIT** relationship between the trading parties. Just to name a few, there's the "B.F.F. rate," the "customer rate," and the "ex-wife-you-took-everything rate." It's like asking for a loan at your local bank. The better your credit standing and reputation with them, the better the interest rates and the larger loan you can avail.

Next on the ladder are the hedge funds, corporations, retail market makers, and retail ECNs. Since these institutions do not have tight credit relationships with the participants of the interbank market, they have to do their transactions via commercial banks. This means that their rates are slightly higher and more expensive than those who are part of the interbank market.

At the very bottom of the ladder are the retail traders. It used to be very hard for us little people to engage in the forex market but, thanks to the advent of the internet, electronic trading, and retail brokers, the difficult barriers to entry in forex trading have all been taken down. This gave us the chance to play with those high up the ladder and poke them with a very long and cheap stick.

Now that you know the forex market structure, let's get to know them forex market playaz!

# Market Players

Now that you know the overall structure of the forex market, let's delve in a little deeper to find out who exactly these people in the ladder are. It is essential for you that you understand the nature of the spot forex market and who are the main players.

Until the late 1990s, only the "big guys" could play this game. The initial requirement was that you could trade only if you had about ten to fifty million bucks to start with! Forex was originally intended to be used by bankers and large institutions, and not by us "little guys." However, because of the rise of the internet, online forex trading firms are now able to offer trading accounts to "retail" traders like us.

Without further ado, here are the major market players:

### *1. The Super Banks*

Since the forex spot market is decentralized, it is the largest banks in the world that determine the exchange rates. Based on the supply and demand for currencies, they are generally the ones that make the bid/ask spread that we all love (or hate, for that matter).

These large banks, collectively known as the interbank market, take on a ridonkulous amount of forex transactions each day for both their customers and themselves. A couple

of these super banks include UBS, Barclays Capital, Deutsche Bank, and Citigroup. You could say that the interbank market is THE foreign exchange market.

### *2. Large Commercial Companies*

Companies take part in the foreign exchange market for the purpose of doing business. For instance, Apple must first exchange its U.S. dollars for the Japanese yen when purchasing electronic parts from Japan for their products. Since the volume they trade is much smaller than those in the interbank market, this type of market player typically deals with commercial banks for their transactions.

Mergers and acquisitions (M&A) between large companies can also create currency exchange rate fluctuations. In international cross-border M&As, a lot of currency conversations happens that could move prices around.

### *3. Governments and Central Banks*

Governments and central banks, such as the European Central Bank, the Bank of England, and the Federal Reserve, are regularly involved in the forex market too. Just like companies, national governments participate in the forex market for their operations, international trade payments, and handling their foreign exchange reserves.

Meanwhile, central banks affect the forex market when they adjust interest rates to control inflation. By doing this, they can affect currency valuation. There are also instances when central banks intervene, either directly or verbally, in the forex market when they want to realign exchange rates. Sometimes, central banks think that their currency is priced too high or too low, so they start massive sell/buy operations to alter exchange rates.

### *4. The Speculators*

"In it to win it!"

This is probably the mantra of the speculators. Comprising close to 90% of all trading volume, speculators come in all shapes and sizes. Some have fat pockets, some roll thin, but all of them engage in the forex simply to make bucket loads of cash.

Don't worry... Once you graduate from the School of Pipsology, you can be part of this cool crowd! Of course, how can you be one of the cool cats if you don't even know your forex history?

# Know Your History!

At the end of the World War II, the whole world was experiencing so much chaos that the major Western governments felt the need to create a system to stabilize the global economy.

Known as the "Bretton Woods System," the agreement set the exchange rate of all currencies against gold. This stabilized exchange rates for a while, but as the major economies of the world started to change and grow at different speeds, the rules of the system soon became obsolete and limiting.

Soon enough, come 1971, the Bretton Woods Agreement was abolished and replaced by a different currency valuation system. With the United States in the pilot's seat, the currency market evolved to a free-floating one, where exchange rates were determined by supply and demand.

At first, It was difficult to determine fair exchange rates, but advances in technology and communication eventually made things easier.

Once the 1990s came along, thanks to computer nerds and the booming growth of the internet (cheers to you Mr. Al Gore), banks began creating their own trading platforms. These platforms were designed to stream live quotes to their clients so that they could instantly execute trades themselves.

Meanwhile, some smart business-minded marketing machines introduced internet-based trading platforms for individual traders.

Known as "retail forex brokers", these entities made it easy for individuals to trade by allowing smaller trade sizes. Unlike in the interbank market where the standard trade size is one million units, retail brokers allowed individuals to trade as little as 1000 units!

## *Retail Forex Brokers*

In the past, only the big speculators and highly capitalized investment funds could trade currencies, but thanks to retail forex brokers and the Internet, this isn't the case anymore.

With hardly any barriers to entry, anybody could just contact a broker, open up an account, deposit some money, and trade forex from the comfort of their own home. Brokers basically come in two forms:

1. Market makers, as their name suggests, "make" or set their own bid and ask prices themselves and

2. Electronic Communications Networks (ECN), who use the best bid and ask prices available to them from different institutions on the interbank market.

### *Market Makers*

Let's say you wanted to go to France to eat some snails. In order for you to transact in the country, you need to get your hands on some euros first by going to a bank or the local foreign currency exchange office. For them to take the opposite side of your transaction, you have to agree to exchange your home currency for euros at the price they set.

Like in all business transactions, there is a catch. In this case, it comes in the form of the bid/ask spread.

For instance, if the bank's buying price (bid) for EUR/USD is 1.2000, and their selling price (ask) is 1.2002, then the bid/ask spread is 0.0002. Although seemingly small, when you're talking about millions of these forex transactions every day, it does add up to create a hefty profit for the market makers!

You could say that market makers are the fundamental building blocks of the foreign exchange market. Retail market makers basically provide liquidity by "repackaging" large contract sizes from wholesalers into bite size pieces. Without them, it will be very hard for the average Joe to trade forex.

### *Electronic Communications Network*

Electronic Communication Network is the name given for trading platforms that automatically match customer's buy and sell orders at stated prices. These stated prices are gathered from different market makers, banks, and even other traders who use the ECN. Whenever a certain sell or buy order is made, it is matched up to the best bid/ask price out there.

Due to ability of traders to set their own prices, ECN brokers typically charge a VERY small commission for the trades you take. The combination of tight spreads and small commission usually make transaction costs cheaper on ECN brokers.

Of course, it's not enough to know the big guys in the biz. As Big Pippin once said, "Trading requires timing". Do you know WHEN you should trade?

# Trading Sessions

# Forex Fundamental Course

Now that you know **what** forex is, **why** you should trade it, and **who** makes up the forex market, it's about time you learned **when** you can trade.

Yes, it is true that the forex market is open 24 hours a day, but that doesn't mean it's always active the whole day.

You can make money trading when the market moves up, and you can even make money when the market moves down.

**BUT** you will have a very difficult time trying to make money when the market doesn't move at all.

And believe us, there will be times when the market is as still as the victims of Medusa. This lesson will help determine when the best times of the day are to trade.

## *Market Hours*

Before looking at the best times to trade, we must look at what a 24-hour day in the forex world looks like.

The forex market can be broken up into four major trading sessions: the Sydney session, the Tokyo session, the London session, and Pipcrawler's favorite time to trade, the New York session. Below are tables of the open and close times for each session:

**Summer**

| Time Zone | EDT | GMT |
|---|---|---|
| Sydney Open | 6:00 PM | 10:00 PM |
| Sydney Close | 3:00 AM | 7:00 AM |
| Tokyo Open | 7:00 PM | 11:00 PM |
| Tokyo Close | 4:00 AM | 8:00 AM |
| London Open | 3:00 AM | 7:00 AM |
| London Close | 12:00 PM | 4:00 PM |
| New York Open | 8:00 AM | 12:00 PM |
| New York Close | 5:00 PM | 9:00 PM |

**Winter**

| Time Zone | EST | GMT |
|---|---|---|
| Sydney Open | 4:00 PM | 9:00 PM |
| Sydney Close | 1:00 AM | 6:00 AM |
| Tokyo Open | 6:00 PM | 11:00 PM |
| Tokyo Close | 3:00 AM | 8:00 AM |
| London Open | 3:00 AM | 8:00 AM |
| London Close | 12:00 PM | 5:00 PM |
| New York Open | 8:00 AM | 1:00 PM |
| New York Close | 5:00 PM | 10:00 PM |

You can see that in between each session, there is a period of time where two sessions are open at the same time. From 3:00-4:00 am EDT, the Tokyo session and London session overlap, and from 8:00 am-12:00 pm EDT, the London session and the New York session overlap.

Naturally, these are the busiest times during the trading day because there is more volume when two markets are open at the same time. This makes sense because during those times, all the market participants are wheelin' and dealin', which means that more money is transferring hands.

Now, you're probably looking at the Sydney open and thinking why it shifts two hours. You'd think that Sydney's open would only move one hour when the U.S. adjusts for standard time, but remember that when the U.S. shifts one hour back, Sydney actually moves forward by one hour (seasons are opposite in Australia). You should always remember this if you ever plan to trade during that time period.

Let's take a look at the average pip movement of the major currency pairs during each trading session.

| Pair | Tokyo | London | New York |
|---|---|---|---|
| EUR/USD | 76 | **114** | 92 |
| GBP/USD | 92 | **127** | 99 |
| USD/JPY | 51 | **66** | 59 |
| AUD/USD | 77 | **83** | 81 |
| NZD/USD | 62 | **72** | 70 |
| USD/CAD | 57 | **96** | 96 |
| USD/CHF | 67 | **102** | 83 |
| EUR/JPY | 102 | **129** | 107 |
| GBP/JPY | 118 | **151** | 132 |
| AUD/JPY | 98 | **107** | 103 |
| EUR/GBP | 78 | **61** | 47 |
| EUR/CHF | 79 | **109** | 84 |

From the table, you will see that the European session normally provides the most movement.

Let's take a more in depth look at each of the session, as well as those periods when the sessions overlap.

# Tokyo Session

The opening of the Asian session at 7:00 pm EST marks the start of the forex clock. You should take note that Tokyo session is sometimes referred to as the Asian session, because Tokyo is the financial capital of Asia.

One thing worth noting is that Japan is the third largest forex trading center in the world.

This shouldn't be too surprising since the yen is the third most traded currency, partaking in 16.50% of all forex transactions. Overall, about 21% of all forex transactions take place during this session.

Below is a table of the Asian session pip ranges of the major currency pairs.

| Pair | Tokyo |
|---|---|
| EUR/USD | 76 |
| GBP/USD | 92 |
| USD/JPY | 51 |
| AUD/USD | 77 |
| NZD/USD | 62 |
| USD/CAD | 57 |
| USD/CHF | 67 |
| EUR/JPY | 102 |
| GBP/JPY | 118 |
| AUD/JPY | 98 |
| EUR/GBP | 78 |
| EUR/CHF | 79 |

Here some key characteristics that you should know about the Tokyo session:

- Action isn't only limited to Japanese shores. Tons of forex transactions are made in other financial hot spots like Hong Kong, Singapore, and Sydney.
- The main market participants during the Tokyo session are commercial companies (exporters) and central banks. Remember, Japan's economy is heavily

export dependent and, with China also being a major trade player, there are a lot of transactions taking place on a daily basis.

- Liquidity can sometimes be very thin. There will be times when trading during this period will be like fishing - you might have to wait a long, long time before getting a nibble.
- It is more likely that you will see stronger moves in Asia Pacific currency pairs like AUD/USD and NZD/USD as opposed to non-Asia Pacific pairs like GBP/USD.
- During those times of thin liquidity, most pairs may stick within a range. This provides opportunities for short day trades or potential breakout trades later in the day.
- Most of the action takes place early in the session, when more economic data is released.
- Moves in the Tokyo session could set the tone for the rest of the day. Traders in latter sessions will look at what happened during the Tokyo session to help organize and evaluate what strategies to take in other sessions.
- Typically, after big moves in the preceding New York session, you may see consolidation during the Tokyo session.

### *Which Pairs Should You Trade?*

Since the Tokyo session is when news from Australia, New Zealand, and Japan comes out, this presents a good opportunity to trade news events. Also, there could be more movement in yen pairs as a lot of yen is changing hands as Japanese companies are conducting business.

Take note that China is also an economic super power, so whenever news comes out from China, it tends to create volatile moves. With Australia and Japan relying heavily on Chinese demand, we could see greater movement in AUD and JPY pairs when Chinese data comes in.

Now let's check out how you can trade the London session.

# London Session

Just when Asian market participants are starting to close shop, their European counterparts are just beginning their day.

While there are several financial centers all around Europe, it is London that market participants keep their eyes on.

Historically, London has always been at a center of trade, thanks to its strategic location. It's no wonder that it is considered the forex capital of the world with thousands of

businessmen making transactions every single minute. About 30% of all forex transactions happen during the London session.

Below is a table of the London session pip ranges of the major currency pairs.

| Pair | London |
|---|---|
| EUR/USD | 114 |
| GBP/USD | 127 |
| USD/JPY | 66 |
| AUD/USD | 83 |
| NZD/USD | 72 |
| USD/CAD | 96 |
| USD/CHF | 102 |
| EUR/JPY | 129 |
| GBP/JPY | 151 |
| AUD/JPY | 107 |
| EUR/GBP | 61 |
| EUR/CHF | 109 |

Here are some neat facts about European session:

- Because the London session crosses with the two other major trading sessions--and with London being such a key financial center--a large chunk of forex transactions take place during this time. This leads to high liquidity and potentially lower transaction costs, i.e., lower pip spreads.
- Due to the large amount of transactions that take place, the London trading session is normally the most volatile session.
- Most trends begin during the London session, and they typically will continue until the beginning of the New York session.
- Volatility tends to die down in the middle of the session, as traders often go off to eat lunch before waiting for the New York trading period to begin.
- Trends can sometimes reverse at the end of the London session, as European traders may decide to lock in profits.

## *Which Pairs Should You Trade?*

Because of the volume of transactions that take place, there is so much liquidity during the European session that almost any pair can be traded.

Of course, it may be best to stick with the majors (EUR/USD, GBP/USD, USD/JPY, and USD/CHF), as these normally have the tightest spreads.

Also, it is these pairs that are normally directly influenced by any news reports that come out during the European session.

You can also try the yen crosses (more specifically, EUR/JPY and GBP/JPY), as these tend to be pretty volatile at this time. Because these are cross pairs, the spreads might be a little wider though.

Next up, we have the New York session, a jungle where dreams are made of. Hey, isn't that an Alicia Keys song?

# New York Session

Right as European traders are getting back from their lunch breaks, the U.S. session begins at 8:00 am EST as traders start rolling into the office. Just like Asia and Europe, the U.S. session has one major financial center that the markets keep their eyes on. We're talking of course, about the "City That Never Sleeps" - New York City baby! The concrete jungle where dreams are made of!

Below is a table of the New York session pip ranges of the major currency pairs.

| Pair | New York |
|---|---|
| EUR/USD | 92 |
| GBP/USD | 99 |
| USD/JPY | 59 |
| AUD/USD | 81 |
| NZD/USD | 70 |
| USD/CAD | 96 |
| USD/CHF | 83 |
| EUR/JPY | 107 |
| GBP/JPY | 132 |
| AUD/JPY | 103 |
| EUR/GBP | 47 |
| EUR/CHF | 84 |

Here are some tips you should know about trading during the U.S. session:

- There is high liquidity during the morning, as it overlaps with the European session.

- Most economic reports are released near the start of the New York session. Remember, about 85% of all trades involve the dollar, so whenever big time U.S. economic data is released, it has the potential to move the markets.
- Once European markets close shop, liquidity and volatility tends to die down during the afternoon U.S. session.
- There is very little movement Friday afternoon, as Asian traders are out singing in karaoke bars while European traders head off to the pub to watch the soccer match.
- Also on Fridays, there is the chance of reversals in the second half of the session, as U.S. traders close their positions ahead of the weekend, in order to limit exposure to any weekend news.

### *Which Pairs Should You Trade?*

Take note that there will be a ton of liquidity as both the U.S. and European markets will be open at the same time. You can bet that banks and multinational companies are burning up the telephone wires. This allows you to trade virtually any pair, although it would be best if you stuck to the major and minor pairs and avoid those weird ones.

Also, because the U.S. dollar is on the other side of the majority of transactions, everybody will be paying attention to U.S. data that is released. Should these reports come in better or worse than expected, it could dramatically shake up the markets, as the dollar will be jumping up and down.

Confused on which sessions start when? we made the next section just for you!

# Session Overlaps

Quick pop quiz! What time of the day are TV ratings highest? If you said during prime time, then you would be correct!

What does this have to do with trading sessions? Well, just like TV, "ratings" (a.k.a. liquidity) are at their highest when there are more people participating in the markets.

Logically, you would think that this happens during the overlap between two sessions. If you thought that way, you'd only be half right. Let's discuss some of the characteristics of the two overlap sessions to see why.

### *Tokyo - London Overlap*

Liquidity during this session is pretty thin for a few reasons. Typically, there isn't as much movement during the Asian session so, once the afternoon hits, it's pretty much a snooze fest. With European traders just starting to get into their offices, trading can be boring as liquidity dries up.

This would be an ideal time to take a chill pill, play some putt-putt or look for potential trades to take for the London and New York sessions.

### *London - New York Overlap*

This is when the real shebang begins! You can literally hear traders crack their knuckles during this time, because they know they have their work cut out for them. This is the busiest time of day, as traders from the two largest financial centers (London and New York) begin duking it out.

It is during this period where we can see some big moves, especially when news reports from the U.S. and Canada are released. The markets can also be hit by "late" news coming out of Europe.

If any trends were established during the European session, we could see the trend continue, as U.S. traders decide to jump in and establish their positions after reading up what happened earlier in the day. You should watch out though, at the end of this session, as some European traders may be closing their positions, which could lead to some choppy moves right before lunch time in the U.S.

# Best Days of the Week to Trade

So now we know that the London session is the busiest out of all the other sessions, but there are also certain days in the week where all the markets tend to show more movement.

Below is a chart of average pip range for the major pairs for each day of the week:

| Pair | Sunday | Monday | Tuesday | Wednesday | Thursday | Friday |
|---|---|---|---|---|---|---|
| **EUR/USD** | 69 | 109 | 142 | 136 | 145 | 144 |
| **GBP/USD** | 73 | 149 | 172 | 152 | 169 | 179 |
| **USD/JPY** | 41 | 65 | 82 | 91 | 124 | 98 |
| **AUD/USD** | 58 | 84 | 114 | 99 | 115 | 111 |
| **NZD/USD** | 28 | 81 | 98 | 87 | 100 | 96 |
| **USD/CAD** | 43 | 93 | 112 | 106 | 120 | 125 |
| **USD/CHF** | 55 | 84 | 119 | 107 | 104 | 116 |
| **EUR/JPY** | 19 | 133 | 178 | 159 | 223 | 192 |
| **GBP/JPY** | 100 | 169 | 213 | 179 | 270 | 232 |
| **EUR/GBP** | 35 | 74 | 81 | 79 | 75 | 91 |
| **EUR/CHF** | 35 | 55 | 55 | 64 | 87 | 76 |

As you can see from the chart above, it would probably be best to trade during the middle of the week, since this is when the most action happens.

Fridays are usually busy until 12:00 pm EST and then the market pretty much drops dead until it closes at 5:00 pm EST. This means we only work half-days on Fridays.

The weekend always starts early! Yippee!

So based on all these, we've learned when the busiest times of the market are. The busiest times are the best times to trade because they give you a higher chance of success.

## *Managing Yo Time Wisely*

Unless you're Edward Cullen, who does not sleep, there is no way you can trade all sessions. Even if you could, why would you? While the forex market is open 24 hours daily, it doesn't mean that action happens all the time!

Besides, sleep is an integral part of a healthy lifestyle!

You need sleep to recharge and have energy so that you can do even the most mundane tasks like mowing the lawn, talking to your spouse, taking the dog for a walk, or organizing your stamp collection. You'll definitely need your rest if you plan on becoming a hotshot trader.

Each trader should learn when to trade.

Actually, scratch that.

Each trader should know when to trade and when **NOT** to trade.

Knowing the optimal times you should trade and the times when you should sit out and just play some Plants vs. Zombies can help save you a pound of moolah (pun intended).

Here's a quick cheat sheet of the best and worst times to trade:

## *Best Times to Trade:*

- When two sessions are overlapping of course! These are also the times where major news events come out to potentially spark some volatility and directional movements. Make sure you bookmark the Market Hours cheat sheet to take note of the Opening and Closing times.
- The European session tends to be the busiest out of the three.
- The middle of the week typically shows the most movement, as the pip range widens for most of the major currency pairs.

***Worst Times to Trade:***

- Sundays - everyone is sleeping or enjoying their weekend!
- Fridays - liquidity dies down during the latter part of the U.S. session.
- Holidays - everybody is taking a break.
- Major news events - you don't want to get whipsawed!
- During American Idol, the NBA Finals, or the Superbowl.

Can't seem to trade during the optimal sessions? Don't fret. You can always be a swing or position trader. We'll get back to that later. Meanwhile, let's move on to how you actually make money in Forex. Excited? You should be!

# How You Make Money in Forex

In the forex market, you buy or sell currencies.

Placing a trade in the foreign exchange market is simple: the mechanics of a trade are very similar to those found in other markets (like the stock market), so if you have any experience in trading, you should be able to pick it up pretty quickly.

The object of forex trading is to exchange one currency for another in the expectation that the price will change, so that the currency you bought will increase in value compared to the one you sold.

Example:

| Trader's Action | EUR | USD |
|---|---|---|
| You purchase 10,000 euros at the EUR/USD exchange rate of **1.1800** | +10,000 | -11,800* |
| Two weeks later, you exchange your 10,000 euros back into U.S. dollar at the exchange rate of **1.2500** | -10,000 | +12,500** |
| You earn a profit of **$700** | 0 | +700 |

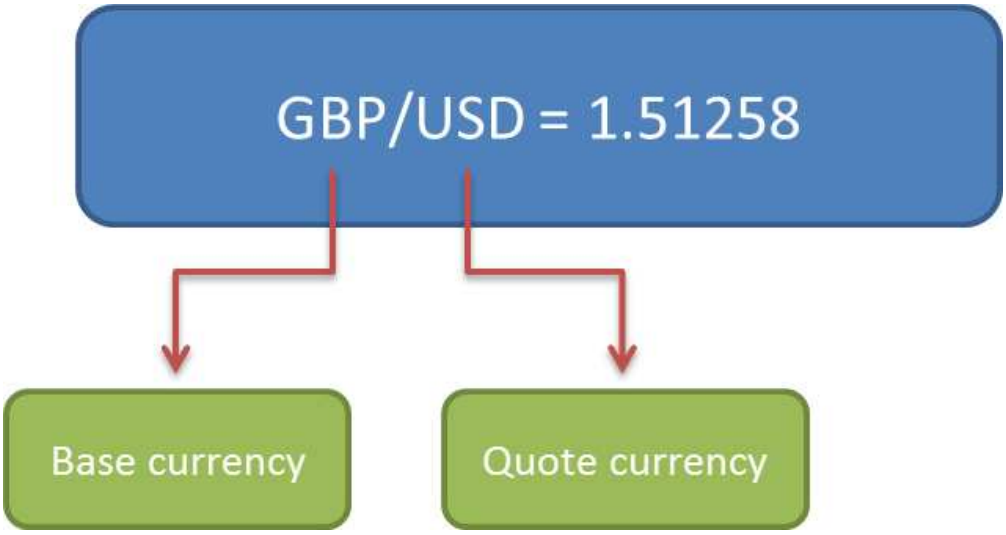
*EUR 10,000 x 1.18 = US $11,800

** EUR 10,000 x 1.25 = US $12,500

An exchange rate is simply the ratio of one currency valued against another currency. For example, the USD/CHF exchange rate indicates how many U.S. dollars can purchase one Swiss franc, or how many Swiss francs you need to buy one U.S. dollar.

## *How to Read a Forex Quote*

Currencies are always quoted in pairs, such as GBP/USD or USD/JPY. The reason they are quoted in pairs is because in every foreign exchange transaction, you are simultaneously buying one currency and selling another. Here is an example of a foreign exchange rate for the British pound versus the U.S. dollar:




The first listed currency to the left of the slash ("/") is known as the **base currency** (in

this example, the British pound), while the second one on the right is called the **counter or quote currency** (in this example, the U.S. dollar).

When buying, the exchange rate tells you how much you have to pay in units of the quote currency to buy one unit of the base currency. In the example above, you have to pay 1.51258 U.S. dollars to buy 1 British pound.

When selling, the exchange rate tells you how many units of the quote currency you get for selling one unit of the base currency. In the example above, you will receive 1.51258 U.S. dollars when you sell 1 British pound.

**The base currency is the "basis" for the buy or the sell.** If you buy EUR/USD this simply means that you are buying the base currency and simultaneously selling the quote currency. In caveman talk, "buy EUR, sell USD."

You would buy the pair if you believe the base currency will appreciate (gain value) relative to the quote currency. You would sell the pair if you think the base currency will depreciate (lose value) relative to the quote currency.

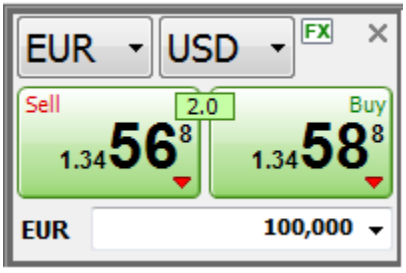
## *Long/Short*

First, you should determine whether you want to buy or sell.

If you want to buy (which actually means buy the base currency and sell the quote currency), you want the base currency to rise in value and then you would sell it back at a higher price. In trader's talk, this is called "going long" or taking a "long position." Just remember: **long = buy.**

If you want to sell (which actually means sell the base currency and buy the quote currency), you want the base currency to fall in value and then you would buy it back at a lower price. This is called "going short" or taking a "short position". Just remember: **short = sell.**

## *Bid/Ask*




"How come I keep getting quoted with two prices?"

All forex quotes are quoted with two prices: the bid and ask. For the most part, the **bid** is lower than the **ask** price.

The **bid** is the price at which your broker is willing to buy the base currency in exchange for the quote currency. This means the bid is the best available price at which you (the trader) will sell to the market.

The **ask** is the price at which your broker will sell the base currency in exchange for the quote currency. This means the ask price is the best available price at which you will buy from the market. **Another word for ask is the offer price.**

The difference between the bid and the ask price is popularly known as the **spread**.

On the EUR/USD quote above, the bid price is 1.34568 and the ask price is 1.34588. Look at how this broker makes it so easy for you to trade away your money.

If you want to sell EUR, you click "Sell" and you will sell euros at 1.34568. If you want to buy EUR, you click "Buy" and you will buy euros at 1.34588.

Now let's take a look at some samples.

# Time to Make Some Dough

In the following examples, we are going to use fundamental analysis to help us decide whether to buy or sell a specific currency pair.

If you always fell asleep during your economics class or just flat out skipped economics class, don't worry! We will cover fundamental analysis in a later lesson.

But right now, try to pretend you know what's going on...

### *EUR/USD*

In this example, the euro is the base currency and thus the "basis" for the buy/sell.

If you believe that the U.S. economy will continue to weaken, which is bad for the U.S. dollar, you would execute a **BUY** EUR/USD order. By doing so, you have bought euros in the expectation that they will rise versus the U.S. dollar.

If you believe that the U.S. economy is strong and the euro will weaken against the U.S. dollar you would execute a **SELL** EUR/USD order. By doing so you have sold euros in the expectation that they will fall versus the US dollar.

### *USD/JPY*

In this example, the U.S. dollar is the base currency and thus the "basis" for the buy/sell.

If you think that the Japanese government is going to weaken the yen in order to help its export industry, you would execute a **BUY** USD/JPY order. By doing so you have bought U.S dollars in the expectation that they will rise versus the Japanese yen.

If you believe that Japanese investors are pulling money out of U.S. financial markets and converting all their U.S. dollars back to yen, and this will hurt the U.S. dollar, you would execute a **SELL** USD/JPY order. By doing so you have sold U.S dollars in the expectation that they will depreciate against the Japanese yen.

### *GBP/USD*

In this example, the pound is the base currency and thus the "basis" for the buy/sell.

If you think the British economy will continue to do better than the U.S. in terms of economic growth, you would execute a **BUY** GBP/USD order. By doing so you have bought pounds in the expectation that they will rise versus the U.S. dollar.

If you believe the British's economy is slowing while the United States' economy remains strong like Jack Bauer, you would execute a **SELL** GBP/USD order. By doing so you have sold pounds in the expectation that they will depreciate against the U.S. dollar.

### *USD/CHF*

In this example, the U.S. dollar is the base currency and thus the "basis" for the buy/sell.

If you think the Swiss franc is overvalued, you would execute a **BUY** USD/CHF order. By doing so you have bought U.S. dollars in the expectation that they will appreciate versus the Swiss Franc.

If you believe that the U.S. housing market weakness will hurt future economic growth, which will weaken the dollar, you would execute a **SELL** USD/CHF order. By doing so you have sold U.S. dollars in the expectation that they will depreciate against the Swiss franc.

### *Margin Trading*

When you go to the grocery store and want to buy an egg, you can't just buy a single egg; they come in dozens or "lots" of 12.

In forex, it would be just as foolish to buy or sell 1 euro, so they usually come in "lots" of 1,000 units of currency (Micro), 10,000 units (Mini), or 100,000 units (Standard) depending on your broker and the type of account you have (more on "lots" later).

**"But I don't have enough money to buy 10,000 euros! Can I still trade?"**

You can with margin trading!

Margin trading is simply the term used for trading with borrowed capital. This is how you're able to open $1,250 or $50,000 positions with as little as $25 or $1,000. You can conduct relatively large transactions, very quickly and cheaply, with a small amount of initial capital.

Let us explain.

Listen carefully because this is very important!

1. You believe that signals in the market are indicating that the British pound will go up against the U.S. dollar.
2. You open one standard lot (100,000 units GBP/USD), buying with the British pound at 2% margin and wait for the exchange rate to climb. When you buy one lot (100,000 units) of GBP/USD at a price of 1.50000, you are buying 100,000 pounds, which is worth US$150,000 (100,000 units of GBP * 1.50000).

   **If the margin requirement was 2%, then US$3,000 would be set aside in your account to open up the trade (US$150,000 * 2%). You now control 100,000 pounds with just US$3,000.**

   We will be discussing margin more in-depth later, but hopefully you're able to get a basic idea of how it works.

3. Your predictions come true and you decide to sell. You close the position at 1.50500. You earn about $500.

| **Your Actions** | **GBP** | **USD** |
|---|---|---|
| You buy 100,000 pounds at the exchange rate of **1.5000** | +100,000 | -150,000 |
| You blink for two seconds and the GBP/USD exchange rates rises to **1.5050** and you sell. | -100,000 | +150,500 |
| You have earned a **profit of $500**. | 0 | +500 |

When you decide to close a position, the deposit that you originally made is returned to you and a calculation of your profits or losses is done.

This profit or loss is then credited to your account.

What's even better is that, with the development of retail forex trading, there are some brokers who allow traders to have custom lots. This means that you don't need to trade in micro, mini or standard lots! If 1,542 is your favorite number and that's how many units you want trade, then you can!

## *Rollover*

No, this is not the same as rollover minutes from your cell phone carrier! For positions open at your broker's "cut-off time" (usually 5:00 pm EST), there is a daily rollover interest rate that a trader either pays or earns, depending on your established margin and position in the market.

If you do not want to earn or pay interest on your positions, simply make sure they are all closed before 5:00 pm EST, the established end of the market day.

Since every currency trade involves borrowing one currency to buy another, interest rollover charges are part of forex trading. Interest is paid on the currency that is borrowed, and earned on the one that is bought.

If you are buying a currency with a higher interest rate than the one you are borrowing, then the net interest rate differential will be positive (i.e. USD/JPY) and you will earn funds as a result.

Conversely, if the interest rate differential is negative then you will have to pay.

Ask your broker or dealer about specific details regarding rollover.

Also note that many retail brokers do adjust their rollover rates based on different factors (e.g., account leverage, interbank lending rates). Please check with your broker for more information on rollover rates and crediting/debiting procedures.

Here is a chart to help you figure out the interest rate differentials of the major currencies. Accurate as of 10/4/2010.

## *Benchmark Interest Rates*

| Country | Interest Rate |
|---|---|
| United States | 0.25% |
| Euro zone | 1.00% |

| | |
|---|---|
| United Kingdom | 0.50% |
| Japan | 0.10% |
| Canada | 1.00% |
| Australia | 4.50% |
| New Zealand | 3.00% |
| Switzerland | 0.25% |

Later on, we'll teach you all about how you can use interest rate differentials to your advantage.

# Pips and Pipettes

Here is where we're going to do a little math. You've probably heard of the terms "pips", "pipettes", and "lots" thrown around, and here we're going to explain what they are and show you how they are calculated.

Take your time with this information, as it is required knowledge for all forex traders. Don't even think about trading until you are comfortable with pip values and calculating profit and loss.

### *What the heck is a Pip? What about a Pipette?*

The unit of measurement to express the change in value between two currencies is called a "Pip". If EUR/USD moves from 1.2250 to 1.2251, that is ONE PIP. A pip is the last decimal place of a quotation, given that four decimal places are used for pairs without the Japanese yen. If a pair does include the Japanese yen, then the currency quote goes out two decimal places.

**Very Important:** There are brokers that quote currency pairs beyond the standard "4 and 2" decimal places to "5 and 3" decimal places. They are quoting **FRACTIONAL PIPS**, also called pipettes. For instance, if GBP/USD moves from 1.51542 to 1.51543, it moved **ONE PIPETTE**.

As each currency has its own value, it is necessary to calculate the value of a pip for that particular currency. In the following examples, we will use quotes with 4 decimal places.

In currencies where the U.S. dollar is quoted first, the calculation would be as follows:

1. **USD/CHF at 1.5250**

   .0001 divided by exchange rate = pip value
   .0001 / 1.5250 = 0.0000655

2. **USD/CAD at 1.4890**

   .0001 divided by exchange rate = pip value
   .0001 / 1.4890 = 0.00006715

3. **USD/JPY at 119.80**

   Notice this currency pair only goes to two decimal places (most of the other currencies have four decimal places). In this case, 1 pip would be .01.

   .01 divided by exchange rate = pip value
   .01 / 119.80 = 0.0000834

**In the case where the U.S. dollar is not quoted first and we want to get the U.S. dollar value, we have to add one more step.**

1. **EUR/USD at 1.2200**

   .0001 divided by exchange rate = pip value
   So .0001 / 1.2200 = EUR 0.00008196

   BUT we need to get back to U.S. dollars so we add another calculation which is

   EUR x Exchange rate
   So 0.00008196 x 1.2200 = 0.00009999

   When rounded up it would be 0.0001

2. **GBP/USD at 1.7975**

   .0001 divided by exchange rate = pip value
   So .0001 / 1.7975 = GBP 0.0000556

   BUT we need to get back to U.S. dollars so we add another calculation which is

   GBP x Exchange rate
   So 0.0000556 x 1.7975 = 0.0000998

   When rounded up it would be 0.0001

You're probably rolling your eyes back and thinking "Do I really need to work all this out?" Well, the answer is a big fat NO. Nearly all forex brokers will work all this out for you automatically, but it's always good for you to know how they work it out.

If your broker doesn't happen to do this, don't worry - you can use our Pip Value Calculator! Aren't we awesome?

In the next section, we will discuss how these seemingly insignificant amounts can add up.

# Lots, Leverage, and Profit and Loss

In the past, spot forex was traded in specific amounts called lots. The standard size for a lot is 100,000 units. There is also a mini, micro, and nano lot sizes that are 10,000, 1,000, and 100 units respectively.

| Lot | Number of Units |
|---|---|
| Standard | 100,000 |
| Mini | 10,000 |
| Micro | 1,000 |
| Nano | 100 |

As you already know, currencies are measured in pips, which is the smallest increment of that currency. To take advantage of these tiny increments, you need to trade large amounts of a particular currency in order to see any significant profit or loss.

Let's assume we will be using a 100,000 unit (standard) lot size. We will now recalculate some examples to see how it affects the pip value.

1. USD/JPY at an exchange rate of 119.80 (.01 / 119.80) x 100,000 = $8.34 per pip
2. USD/CHF at an exchange rate of 1.4555 (.0001 / 1.4555) x 100,000 = $6.87 per pip

In cases where the U.S. dollar is not quoted first, the formula is slightly different.

1. EUR/USD at an exchange rate of 1.1930 (.0001 / 1.1930) X 100,000 = 8.38 x 1.1930 = $9.99734 rounded up will be $10 per pip
2. GBP/USD at an exchange rate or 1.8040 (.0001 / 1.8040) x 100,000 = 5.54 x 1.8040 = 9.99416 rounded up will be $10 per pip.

Your broker may have a different convention for calculating pip value relative to lot size but whichever way they do it, they'll be able to tell you what the pip value is for the currency you are trading is at the particular time. As the market moves, so will the pip value depending on what currency you are currently trading.

## *What the heck is leverage?*

You are probably wondering how a small investor like yourself can trade such large amounts of money. Think of your broker as a bank who basically fronts you $100,000 to buy currencies. All the bank asks from you is that you give it $1,000 as a good faith deposit, which he will hold for you but not necessarily keep. Sounds too good to be true? This is how forex trading using leverage works.

The amount of leverage you use will depend on your broker and what you feel comfortable with.

Typically the broker will require a trade deposit, also known as "account margin" or "initial margin." Once you have deposited your money you will then be able to trade. The broker will also specify how much they require per position (lot) traded.

For example, if the allowed leverage is 100:1 (or 1% of position required), and you wanted to trade a position worth $100,000, but you only have $5,000 in your account. No problem as your broker would set aside $1,000 as down payment, or the "margin," and let you "borrow" the rest. Of course, any losses or gains will be deducted or added to the remaining cash balance in your account.

The minimum security (margin) for each lot will vary from broker to broker. In the example above, the broker required a one percent margin. This means that for every $100,000 traded, the broker wants $1,000 as a deposit on the position.

## *How the heck do I calculate profit and loss?*

So now that you know how to calculate pip value and leverage, let's look at how you calculate your profit or loss.

Let's buy U.S. dollars and Sell Swiss francs.

1. The rate you are quoted is 1.4525 / 1.4530. Because you are buying U.S. dollars you will be working on the "ask" price of 1.4530, or the rate at which traders are prepared to sell.
2. So you buy 1 standard lot (100,000 units) at 1.4530.
3. A few hours later, the price moves to 1.4550 and you decide to close your trade.
4. The new quote for USD/CHF is 1.4550 / 1.4555. Since you're closing your trade and you initially bought to enter the trade, you now sell in order to close the trade so you must take the "bid" price of 1.4550. The price traders are prepared to buy at.
5. The difference between 1.4530 and 1.4550 is .0020 or 20 pips.
6. Using our formula from before, we now have (.0001/1.4550) x 100,000 = $6.87 per pip x 20 pips = $137.40

Remember, when you enter or exit a trade, you are subject to the spread in the bid/offer quote. When **you buy a currency, you will use the offer or ask price** and when **you sell, you will use the bid price**.

Next up, we'll give you a roundup of the freshest forex lingos you've learned!

# Impress Your Date with Forex Lingo

As in any new skill that you learn, you need to learn the lingo... especially if you wish to win your love's heart. You, the newbie, must know certain terms like the back of your hand before making your first trade. Some of these terms you've already learned, but it never hurts to do a little review

## *Major and Minor Currencies*

The eight most frequently traded currencies (USD, EUR, JPY, GBP, CHF, CAD, NZD, and AUD) are called the major currencies or the "majors." These are the most liquid and the most sexy. All other currencies are referred to as minor currencies.

## *Base Currency*

The base currency is the first currency in any currency pair. The currency quote shows how much the base currency is worth as measured against the second currency. For example, if the USD/CHF rate equals 1.6350, then one USD is worth CHF 1.6350.

In the forex market, the U.S. dollar is normally considered the "base" currency for quotes, meaning that quotes are expressed as a unit of 1 USD per the other currency quoted in the pair. The primary exceptions to this rule are the British pound, the euro, and the Australian and New Zealand dollar.

## *Quote Currency*

The quote currency is the second currency in any currency pair. This is frequently called the pip currency and any unrealized profit or loss is expressed in this currency.

## *Pip*

A pip is the smallest unit of price for any currency. Nearly all currency pairs consist of five significant digits and most pairs have the decimal point immediately after the first digit, that is, EUR/USD equals 1.2538. In this instance, a single pip equals the smallest change in the fourth decimal place - that is, 0.0001. Therefore, if the quote currency in any pair is USD, then one pip always equal 1/100 of a cent.

Notable exceptions are pairs that include the Japanese yen where a pip equals 0.01.

### *Pipette*

One-tenth of a pip. Some brokers quote fractional pips, or pipettes, for added precision in quoting rates. For example, if EUR/USD moved from 1.32156 to 1.32158, it moved 2 pipettes.

### *Bid Price*

The bid is the price at which the market is prepared to buy a specific currency pair in the forex market. At this price, the trader can sell the base currency. It is shown on the left side of the quotation.

For example, in the quote GBP/USD 1.8812/15, the bid price is 1.8812. This means you sell one British pound for 1.8812 U.S. dollars.

### *Ask/Offer Price*

The ask/offer is the price at which the market is prepared to sell a specific currency pair in the forex market. At this price, you can buy the base currency. It is shown on the right side of the quotation.

For example, in the quote EUR/USD 1.2812/15, the ask price is 1.2815. This means you can buy one euro for 1.2815 U.S. dollars. The ask price is also called the offer price.

### *Bid/Ask Spread*

The spread is the difference between the bid and ask price. The "big figure quote" is the dealer expression referring to the first few digits of an exchange rate. These digits are often omitted in dealer quotes. For example, the USD/JPY rate might be 118.30/118.34, but would be quoted verbally without the first three digits as "30/34." In this example, USD/JPY has a 4-pip spread.

### *Quote Convention*

Exchange rates in the forex market are expressed using the following format:
Base currency / Quote currency = Bid / Ask

### *Transaction Cost*

The critical characteristic of the bid/ask spread is that it is also the transaction cost for a round-turn trade. Round-turn means a buy (or sell) trade and an offsetting sell (or buy)

trade of the same size in the same currency pair. For example, in the case of the EUR/USD rate of 1.2812/15, the transaction cost is three pips.

The formula for calculating the transaction cost is:

Transaction cost (spread) = Ask Price - Bid Price

### *Cross Currency*

A cross currency is any pair in which neither currency is the U.S. dollar. These pairs exhibit erratic price behavior since the trader has, in effect, initiated two USD trades. For example, initiating a long (buy) EUR/GBP is equivalent to buying a EUR/USD currency pair and selling GBP/USD. Cross currency pairs frequently carry a higher transaction cost.

### *Margin*

When you open a new margin account with a forex broker, you must deposit a minimum amount with that broker. This minimum varies from broker to broker and can be as low as $100 to as high as $100,000.

Each time you execute a new trade, a certain percentage of the account balance in the margin account will be set aside as the initial margin requirement for the new trade based upon the underlying currency pair, its current price, and the number of units (or lots) traded. The lot size always refers to the base currency.

For example, let's say you open a mini account which provides a 200:1 leverage or 0.5% margin. Mini accounts trade mini lots. Let's say one mini lot equals $10,000. If you were to open one mini-lot, instead of having to provide the full $10,000, you would only need $50 ($10,000 x 0.5% = $50).

### *Leverage*

Leverage is the ratio of the amount capital used in a transaction to the required security deposit (margin). It is the ability to control large dollar amounts of a security with a relatively small amount of capital. Leveraging varies dramatically with different brokers, ranging from 2:1 to 500:1.

Now that you've impressed your dates with your forex lingo, how about showing her the different types of trade orders?

# Types of Orders

The term "order" refers to how you will enter or exit a trade. Here we discuss the different types of orders that can be placed into the foreign exchange market.

Be sure that you know which types of orders your broker accepts. Different brokers accept different types of orders.

There are some basic order types that all brokers provide and some others that sound weird.

## *Order Types*

### Market order

A market order is an order to buy or sell at the best available price.

For example, the bid price for EUR/USD is currently at 1.2140 and the ask price is at 1.2142. If you wanted to buy EUR/USD at market, then it would be sold to you at the ask price of 1.2142. You would click buy and your trading platform would instantly execute a buy order at that exact price.

If you ever shop on Amazon.com, it's kinda like using their 1-Click ordering. You like the current price, you click once and it's yours! The only difference is you are buying or selling one currency against another currency instead of buying a Justin Bieber CD.

### Limit Entry Order

A limit entry is an order placed to either **buy below the market** or **sell above the market** at a certain price.

For example, EUR/USD is currently trading at 1.2050. You want to go short if the price reaches 1.2070. You can either sit in front of your monitor and wait for it to hit 1.2070 (at which point you would click a sell market order), or you can set a sell limit order at 1.2070 (then you could walk away from your computer to attend your ballroom dancing class).

If the price goes up to 1.2070, your trading platform will automatically execute a sell order at the best available price.

You use this type of entry order when you believe price will reverse upon hitting the price you specified!

### Stop-Entry Order

A stop-entry order is an order placed to buy above the market or sell below the market at a certain price.

For example, GBP/USD is currently trading at 1.5050 and is heading upward. You believe that price will continue in this direction if it hits 1.5060. You can do one of the following to play this belief: sit in front of your computer and buy at market when it hits 1.5060 OR set a stop-entry order at 1.5060. You use stop-entry orders when you feel that price will move in one direction!

### Stop-Loss Order

A stop-loss order is a type of order linked to a trade for the purpose of preventing additional losses if price goes against you. **REMEMBER THIS TYPE OF ORDER**. A stop-loss order remains in effect until the position is liquidated or you cancel the stop-loss order.

For example, you went long (buy) EUR/USD at 1.2230. To limit your maximum loss, you set a stop-loss order at 1.2200. This means if you were dead wrong and EUR/USD drops to 1.2200 instead of moving up, your trading platform would automatically execute a sell order at 1.2200 the best available price and close out your position for a 30-pip loss (eww!).

Stop-losses are extremely useful if you don't want to sit in front of your monitor all day worried that you will lose all your money. You can simply set a stop-loss order on any open positions so you won't miss your basket weaving class or elephant polo game.

### Trailing Stop

A trailing stop is a type of stop-loss order attached to a trade that moves as price fluctuates.

Let's say that you've decided to short USD/JPY at 90.80, with a trailing stop of 20 pips. This means that originally, your stop loss is at 91.00. If price goes down and hits 90.50, your trailing stop would move down to 90.70.

Just remember though, that your stop will STAY at this price. It will not widen if price goes against you. Going back to the example, with a trailing stop of 20 pips, if USD/JPY hits 90.50, then your stop would move to 90.70. However, if price were to suddenly move up to 90.60, your stop would remain at 90.70.

Your trade will remain open as long as price does not move against you by 20 pips. Once price hits your trailing stop, a stop-loss order will be triggered and your position will be closed.

## *Weird Orders*

"Can I order a grande extra hot soy with extra foam, extra hot split quad shot with a half squirt of sugar-free white chocolate and a half squirt of sugar-free cinnamon, a half

packet of Splenda and put that in a venti cup and fill up the "room" with extra whipped cream with caramel and chocolate sauce drizzled on top?"

Ooops, wrong weird order.

### Good 'Till Cancelled (GTC)

A GTC order remains active in the market until you decide to cancel it. Your broker will not cancel the order at any time. Therefore it's **your responsibility** to remember that you have the order scheduled.

### Good for the Day (GFD)

A GFD order remains active in the market until the end of the trading day. Because foreign exchange is a 24-hour market, this usually means 5:00 pm EST since that's the time U.S. markets close, but we'd recommend you double check with your broker.

### One-Cancels-the-Other (OCO)

An OCO order is a mixture of two entry and/or stop-loss orders. Two orders with price and duration variables are placed above and below the current price. When one of the orders is executed the other order is canceled.

Let's say the price of EUR/USD is 1.2040. You want to either buy at 1.2095 over the resistance level in anticipation of a breakout or initiate a selling position if the price falls below 1.1985. The understanding is that if 1.2095 is reached, your buy order will be triggered and the 1.1985 sell order will be automatically canceled.

### One-Triggers-the-Other

An OTO is the opposite of the OCO, as it only puts on orders when the parent order is triggered. You set an OTO order when you want to set profit taking and stop loss levels ahead of time, even before you get in a trade.

For example, USD/CHF is currently trading at 1.2000. You believe that once it hits 1.2100, it will reverse and head downwards but only up to 1.1900. The problem is that you will be gone for an entire week because you have to join a basket weaving competition at the top of Mt. Fiji where there is no internet.

In order to catch the move while you are away, you set a sell limit at 1.2000 and at the same time, place a related buy limit at 1.1900, and just in case, place a stop-loss at 1.2100. As an OTO, both the buy limit and the stop-loss orders will only be placed if your initial sell order at 1.2000 gets triggered.

### *In conclusion...*

The basic order types (market, limit entry, stop-entry, stop loss, and trailing stop) are usually all that most traders ever need.

Unless you are a veteran trader (don't worry, with practice and time you will be), don't get fancy and design a system of trading requiring a large number of orders sandwiched in the market at all times.

Stick with the basic stuff first.

Make sure you fully understand and are comfortable with your broker's order entry system before executing a trade.

Also, always check with your broker for specific order information and to see if any rollover fees will be applied if a position is held longer than one day. Keeping your ordering rules simple is the best strategy.

**DO NOT** trade with real money until you have an extremely high comfort level with the trading platform you are using and its order entry system. Erroneous trades are more common than you think!

# Demo Your Way to Success

You can open a demo accounts for FREE with most forex brokers. These "pretend" accounts have the full capabilities of a "real" account.

But why is it free?

It's because the broker wants you to learn the ins and outs of their trading platform, and have a good time trading without risk, so you'll fall in love with them and deposit real money. The demo account allows you to learn about the forex market and test your trading skills with ZERO risk.

Yes, that's right, ZERO!

**YOU SHOULD DEMO TRADE UNTIL YOU DEVELOP A SOLID, PROFITABLE SYSTEM BEFORE YOU EVEN THINK ABOUT PUTTING REAL MONEY ON THE LINE.**

**WE REPEAT - YOU SHOULD DEMO TRADE UNTIL YOU DEVELOP A SOLID, PROFITABLE SYSTEM BEFORE YOU EVEN THINK ABOUT PUTTING REAL MONEY ON THE LINE.**

### *"Don't Lose Your Money" Declaration*

Now, place your hand on your heart and say...

**"I will demo trade until I develop a solid, profitable system before I trade with real money."**

Now touch your head with your index finger and say...

**"I am a smart and patient forex trader!"**

**Do NOT open a live trading account until you are CONSISTENTLY trading PROFITABLY on a demo account.**

If you can't wait until you're profitable on a demo account, at least demo trade for two months. Hey, at least you were able to hold off losing all your money for two months right? If you can't hold out for two months, just donate that money to your favorite charity or cut your hands off.

### *Concentrate on ONE major currency pair.*

It gets far too complicated to keep tabs on more than one currency pair when you first start trading. Stick with one of the majors because they are the most liquid which makes their spreads cheap.

You can be a winner at currency trading but, as in all other aspects of life, it will take hard work, dedication, a little luck, a lot of common sense, and a whole lot of good judgment.

# Protect Yo Self Before You Wreck Yo Self

Before we go any further we are going to be 100% honest with you and tell you the following before you consider trading currencies:

1. **All forex traders, and we do mean ALL traders, LOSE money on trades.**

   Ninety percent of traders lose money, largely due to lack of planning, training, discipline, and having poor money management rules.

   If you hate to lose or are a super perfectionist, you'll also probably have a hard time adjusting to trading because all traders lose a trade at some point or another.

2. **Trading forex is not for the unemployed, those on low incomes, are knee-deep in credit card debt or who can't afford to pay their electricity bill or**

**afford to eat.**

You should have at least $10,000 of trading capital (in a mini account) that you can afford to lose. Don't expect to start an account with a few hundred dollars and expect to become a gazillionaire.

The forex market is one of the most popular markets for speculation, due to its enormous size, liquidity, and tendency for currencies to move in strong trends. You would think traders all over the world would make a killing, but success has been limited to very small percentage of traders.

The problem is that many traders come with the misguided hope of making a gazillion bucks, but in reality, they lack the discipline required for really learning the art of trading. Most people usually lack the discipline to stick to a diet or to go to the gym three times a week.

If you can't even do that, how do you think you're going to succeed one of the most difficult, but financially rewarding, endeavors known to man?

Short term trading IS NOT for amateurs, and it is rarely the path to "get rich quick". You can't make gigantic profits without taking gigantic risks.

A trading strategy that involves taking a massive degree of risk means suffering inconsistent trading performance and large losses. A trader who does this probably doesn't even have a trading strategy - unless you call gambling a trading strategy!

## *Forex Trading is NOT a Get-Rich-Quick Scheme*

**Forex trading is a SKILL that takes TIME to learn.**

Skilled traders can and do make money in this field. However, like any other occupation or career, success doesn't just happen overnight. Forex trading isn't a piece of cake (as some people would like you to believe).

Think about it, if it was, everyone trading would already be millionaires.

The truth is that even expert traders with years of experience still encounter periodic losses.

Drill this in your head: there are NO shortcuts to forex trading.

It takes lots and lots of **PRACTICE** and **EXPERIENCE** to master.

There is no substitute for hard work, deliberate practice, and diligence.

Practice trading on a **DEMO ACCOUNT** until you find a method that you know inside and out, and can comfortably execute objectively. Basically, find the way that works for you!!!

# The Big Three

Congratulations! You've gotten through the Pre-School and, with a few boo-boos here and there, you are ready to begin your first day of class!

You did go through the Pre-School, right????

By now you've learned some history about the forex, how it works, what affects the prices, blah blah blah.

ZZZ

**OR...**

You can take the **green pill**, which is fully loaded with the dollar extract, and learn how you can make money for yourself in the most active market in the world, simply by using a little brain power.

Just remember, your education will never stop. Even after you graduate from the School of Pipsology, you must constantly pursue as much knowledge as you can, so that you can become a true FOREX MASTER! The learning never ends!

Are you ready to make that commitment?

Now pop that green pill in, wash it down with some delicious chocolate milk, and grab your lunchbox... the School of Pipsology is now in session!

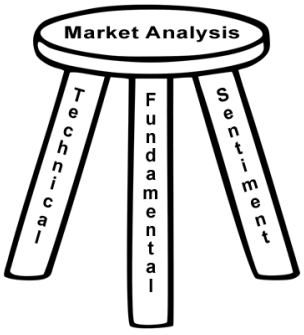
*Note: the green pill was made with a brainwashing serum. You will now obey everything that we tell you to do! Mwuahahaha! <--- evil laugh*

## *Three Types of Market Analysis*

To begin, let's look at three ways on how you would analyze and develop ideas to trade the market. There are three basic types of market analysis:

1. Technical Analysis
2. Fundamental Analysis
3. Sentiment Analysis

There has always been a constant debate as to which analysis is better, but to tell you the truth, you need to know all three.




It's kind of like standing on a three-legged stool - if one of the legs is weak, the stool will break under your weight and you'll fall flat on your face. The same holds true in trading.

If your analysis on any of the three types of trading is weak and you ignore it, there's a good chance that it will cause you to lose out on your trade!

# Technical Analysis

Technical analysis is the framework in which traders study price movement.

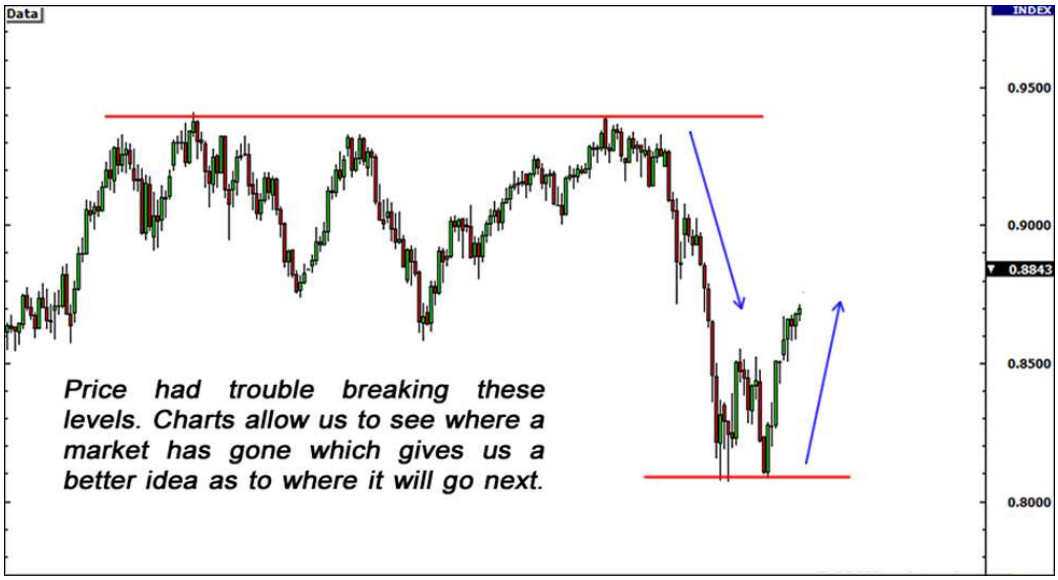
The theory is that a person can look at historical price movements and determine the current trading conditions and potential price movement.

The main evidence for using technical analysis is that, theoretically, all current market information is reflected in price. If price reflects all the information that is out there, then price action is all one would really need to make a trade.

Now, have you ever heard the old adage, "**History tends to repeat itself**"?

Well, that's basically what technical analysis is all about! If a price level held as a key support or resistance in the past, traders will keep an eye out for it and base their trades around that historical price level.

Technical analysts look for similar patterns that have formed in the past, and will form trade ideas believing that price will act the same way that it did before.


Data
INDEX
0.9500
0.9000
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Price had trouble breaking these levels. Charts allow us to see where a market has gone which gives us a better idea as to where it will go next.

In the world of trading, when someone says technical analysis, the first thing that comes to mind is a chart. Technical analysts use charts because they are the easiest way to visualize historical data!

You can look at past data to help you spot trends and patterns which could help you find some great trading opportunities.

What's more is that with all the traders who rely on technical analysis out there, these price patterns and indicator signals tend to become self-fulfilling.

As more and more traders look for certain price levels and chart patterns, the more likely that these patterns will manifest themselves in the markets.

You should know though that technical analysis is VERY subjective.

Just because Ralph and Joseph are looking at the exact same chart setup or indicators doesn't mean that they will come up with the same idea of where price may be headed.

The important thing is that you understand the concepts under technical analysis so you won't get nosebleeds whenever somebody starts talking about Fibonacci, Bollinger bands, or pivot points.

Now we know you're thinking to yourself, "Geez, these guys are smart. They use crazy words like 'Fibonacci' and 'Bollinger'. I can never learn this stuff!"

Don't worry yourself too much. After you're done with the School of Pipsology, you too will be just as... uhmmm... "smart" as us.

*By the way, do you feel that green pill kicking in yet? Bark like a dog!*

# Fundamental Analysis

Fundamental analysis is a way of looking at the market by analyzing economic, social, and political forces that affects the supply and demand of an asset. If you think about it, this makes a whole lot of sense! Just like in your Economics 101 class, it is supply and demand that determines price.

Using supply and demand as an indicator of where price could be headed is easy. The hard part is analyzing all the factors that affect supply and demand.

In other words, you have to look at different factors to determine whose economy is rockin' like a Taylor Swift song, and whose economy sucks. You have to understand the reasons of why and how certain events like an increase in unemployment affect a country's economy, and ultimately, the level of demand for its currency.

The idea behind this type of analysis is that if a country's current or future economic outlook is good, their currency should strengthen. The better shape a country's economy is, the more foreign businesses and investors will invest in that country. This results in the need to purchase that country's currency to obtain those assets.

In a nutshell, this is what fundamental analysis is:

For example, let's say that the U.S. dollar has been gaining strength because the U.S. economy is improving. As the economy gets better, raising interest rates may be needed to control growth and inflation.

Higher interest rates make dollar-denominated financial assets more attractive. In order to get their hands on these lovely assets, traders and investors have to buy some greenbacks first. As a result, the value of the dollar will increase.

Later on in the course, you will learn which economic data drives currency prices, and why they do so. You will know who the Fed Chairman is and how retail sales data reflects the economy. You'll be spitting out interest rates like baseball statistics.

But that's for another lesson for another time. For now, just know that the fundamental analysis is a way of analyzing a currency through the strength or weakness of that country's economy. It's going to be awesome, we promise!

# Sentiment Analysis

Earlier, we said that price should theoretically accurately reflect all available market information. Unfortunately for us traders, it isn't that simple. The markets do not simply reflect all the information out there because traders will all just act the same way. Of course, that isn't how things work.

Each trader has his own opinion or explanation of why the market is acting the way they do. The market is just like Facebook - it's a complex network made up of individuals who want to spam our news feeds.

Kidding aside, the market basically represents what all traders - you, Pipcrawler, Celine from the donut shop - feel about the market. Each trader's thoughts and opinions, which are expressed through whatever position they take, helps form the overall sentiment of the market.

The problem is that as traders, no matter how strongly you feel about a certain trade, you can't move the markets in your favor (unless you're one of the GSs - George Soros or Goldman Sachs!). Even if you truly believe that the dollar is going to go up, but everyone else is bearish on it, there's nothing much you can do about it.

As a trader, you have to take all this into consideration. It's up to you to gauge how the market is feeling, whether it is bullish or bearish. Ultimately, it's also up to you to find out how you want to incorporate market sentiment into your trading strategy. If you choose to simply ignore market sentiment, that's your choice. But hey, we're telling you now, it's your loss!

Being able to gauge market sentiment can be an important tool in your toolbox. Later on in school, we'll teach you how to analyze market sentiment and use it to your advantage like Jedi mind tricks.

# Which Type of Analysis is Best?

Ahhhh, the million dollar question....

Throughout your journey as an aspiring forex trader you will find strong advocates for each type of analysis. Do not be fooled by these one-sided extremists! One is not better than the other...they are all just different ways to look at the market.

At the end of the day, you should trade based on the type of analysis you are most comfortable and profitable with.

To recap, **technical analysis** is the study of price movement on the charts while **fundamental analysis** takes a look at how the country's economy is doing.

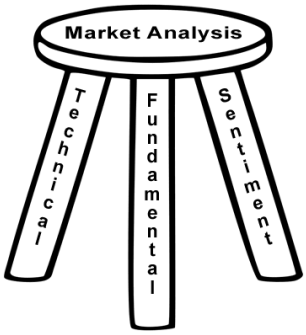
**Market sentiment** analysis determines whether the market is bullish or bearish on the current or future fundamental outlook.

Fundamental factors shape sentiment, while technical analysis helps us visualize that sentiment and apply a framework for our trades.

Those three work hand-in-hand-in-hand to help you come up with good trade ideas. All the historical price action and economic figures are there - all you have to do is put on your thinking cap and put those analytical skills to the test!

Let me pull out that three-legged stool again just to emphasize the importance of all three types of analysis.

Take out one or two legs of the stool and it's going to be shaky!




In order to become a true forex master you will need to know how to effectively use these three types of analysis.

Don't believe us?

Let us give you an example of how focusing on only one type of analysis can turn into a disaster.

- Let's say that you're looking at your charts and you find a good trading opportunity.

  You get all excited thinking about the money that's going to be raining down from the sky.

  You say to yourself, "Man, I've never seen a more perfect trading opportunity in GBP/USD. I love my charts. Mwah. Now show me the money!"

- You then proceed to buy GBP/USD with a big fat smile on your face (the kind where all your teeth are showing).
- But wait! All of a sudden the trade makes a 100 pip move in the **OTHER DIRECTION**! Little did you know, one of the major banks in London filed for bankruptcy! Suddenly, everyone's sentiment towards Britain's market turns sour and everyone trades in the opposite direction!
- Your big fat smile turns into mush and you start getting angry at your charts. You throw your computer on the ground and begin to pulverize it. You just lost a bunch of money, and now your computer is broken into a billion pieces.

  And it's all because you completely ignored fundamental analysis and sentimental analysis.

(Note: This was not based on a real story. This did not happen to us. We were never this naive. We were always smart traders.... From the overused sarcasm, we think you get the picture.)

Ok, ok, so the story was a little over-dramatized, but you get the point.

Remember how your mother used to tell you as a kid that too much of anything is never good?

Well you might've thought that was just hogwash back then but in forex, the same applies when deciding which type of analysis to use.

Don't rely on just one.

Instead, you must learn to balance the use of all of them. It is only then that you can really get the most out of your trading.

## *Where do we go from here?*

Now that you're done with Kindergarten and learned a little bit about each type of analysis, it's time to delve much deeper! Here's what's in store for the next few years of your life...

We're kidding, we're kidding! We're talking about the next few school years in the School of Pipsology.

Grade school will be all about basic technical analysis tools.

You'll learn all about the dynamics behind price action, such as support and resistance levels, candlestick formations, and common chart patterns. You'll experiment with leading and lagging indicators and discover how to use them in coming up with trade ideas. Sounds pretty exciting, doesn't it?

The remaining years of middle school and high school are devoted to studying more technical analysis tools.

We'll take a look at the more advanced tools also such as pivot points, divergences, Elliott Wave Theory, and Gartley patterns. Sounds fancy? It's because they are! Bet you can't wait to get started on those!

College will be a bit more complicated since you'll be tackling both fundamental and market sentiment analysis at the same time. Talk about hitting two stones with one bird! You're the bird and the stones are... well, you get the point.

A couple of reasons why we're putting fundamental and market sentiment analysis together:

- By the time you reach college, you'll be so hooked on learning more about forex that one lesson simply won't be enough.
- It is hard to draw the line between fundamental analysis and market sentiment analysis.

As we mentioned earlier, fundamental factors are mostly responsible for shaping market sentiment. Those two types of analysis would take up both freshman and sophomore year of college.

# Types of Charts

Let's take a look at the three most popular types of charts:

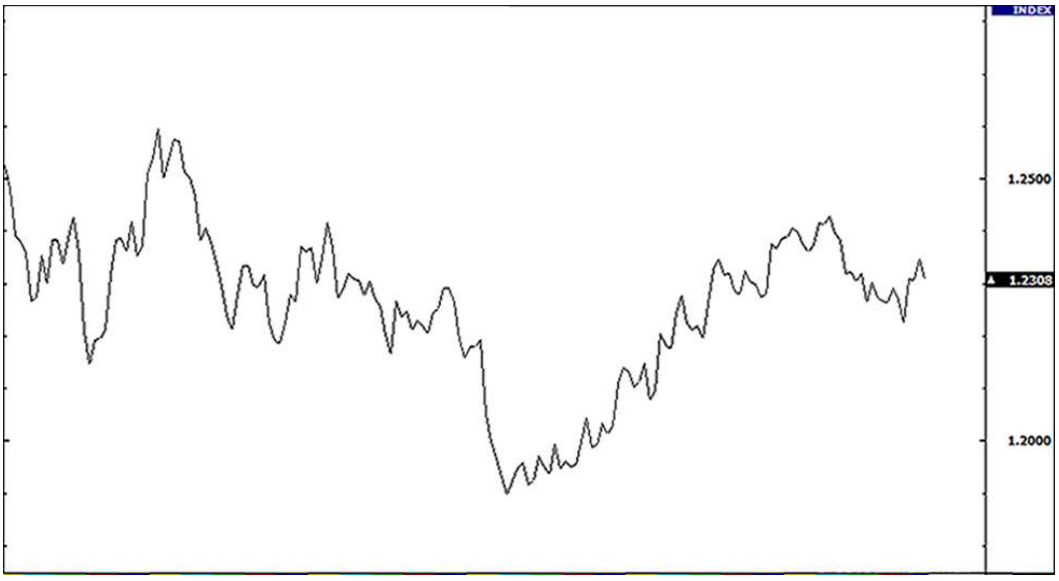
1. Line chart
2. Bar chart
3. Candlestick chart

Now, we'll explain each of the charts, and let you know what you should know about each of them.

### *Line Charts*

A simple line chart draws a line from one closing price to the next closing price. When strung together with a line, we can see the general price movement of a currency pair over a period of time.

Here is an example of a line chart for EUR/USD:



## *Bar Charts*

A bar chart is a little more complex. It shows the opening and closing prices, as well as the highs and lows. The bottom of the vertical bar indicates the lowest traded price for that time period, while the top of the bar indicates the highest price paid.

The vertical bar itself indicates the currency pair's trading range as a whole.

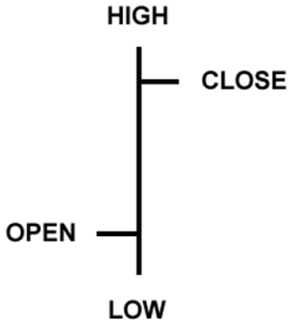
The horizontal hash on the left side of the bar is the opening price, and the right-side horizontal hash is the closing price.

Here is an example of a bar chart for EUR/USD:

Take note, throughout our lessons, you will see the word "bar" in reference to a single piece of data on a chart.

A bar is simply one segment of time, whether it is one day, one week, or one hour. When you see the word 'bar' going forward, be sure to understand what time frame it is referencing.

Bar charts are also called "OHLC" charts, because they indicate the Open, the High, the Low, and the Close for that particular currency. Here's an example of a price bar:




**Open**: The little horizontal line on the left is the opening price
**High**: The top of the vertical line defines the highest price of the time period
**Low**: The bottom of the vertical line defines the lowest price of the time period
**Close**: The little horizontal line on the right is the closing price

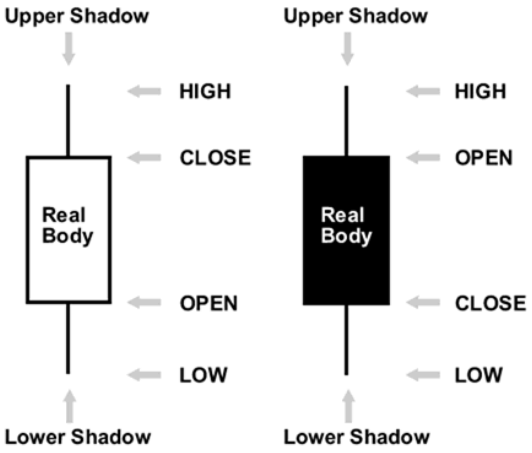
## *Candlesticks Charts*

Candlestick chart show the same information as a bar chart, but in a prettier, graphic format.

Candlestick bars still indicate the high-to-low range with a vertical line.

However, in candlestick charting, the larger block (or body) in the middle indicates the range between the opening and closing prices. Traditionally, if the block in the middle is filled or colored in, then the currency closed lower than it opened.

In the following example, the 'filled color' is black. For our 'filled' blocks, the top of the block is the opening price, and the bottom of the block is the closing price. If the closing price is higher than the opening price, then the block in the middle will be "white" or hollow or unfilled.




Here at BabyPips.com, we don't like to use the traditional black and white candlesticks. They just look so unappealing. And since we spend so much time looking at charts, we feel it's easier to look at a chart that's colored.

A color television is much better than a black and white television, so why not splash some color in those candlestick charts?

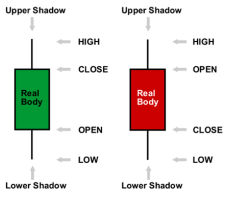
We simply substituted green instead of white, and red instead of black. This means that if the price closed higher than it opened, the candlestick would be green.

If the price closed lower than it opened, the candlestick would be red.

In our later lessons, you will see how using green and red candles will allow you to "see" things on the charts much faster, such as uptrend/downtrends and possible reversal points.

For now, just remember that we use red and green candlesticks instead of black and white and we will be using these colors from now on.

Check out these candlesticks...BabyPips.com style! Awww yeeaaah! You know you like that!




Here is an example of a candlestick chart for EUR/USD. Isn't it pretty?

The purpose of candlestick charting is strictly to serve as a visual aid, since the exact same information appears on an OHLC bar chart. The advantages of candlestick charting are:

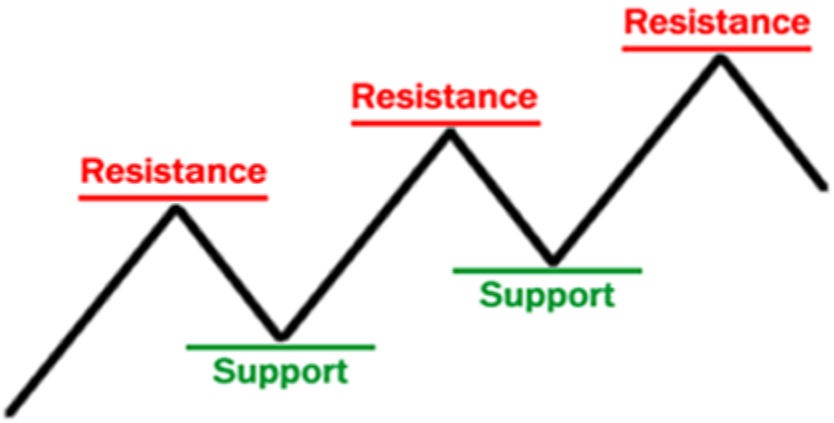
- Candlesticks are easy to interpret, and are a good place for beginners to start figuring out chart analysis.
- Candlesticks are easy to use! Your eyes adapt almost immediately to the information in the bar notation. Plus, research shows that visuals help in studying, it might help with trading as well!
- Candlesticks and candlestick patterns have cool names such as the shooting star, which helps you to remember what the pattern means.
- Candlesticks are good at identifying marketing turning points - reversals from an uptrend to a downtrend or a downtrend to an uptrend. You will learn more about this later.

Now that you know why candlesticks are so cool, it's time to let you know that we will be using candlestick charts for most, if not all of chart examples on this site.

# Support and Resistance

Support and resistance is one of the most widely used concepts in trading. Strangely enough, everyone seems to have their own idea on how you should measure support and resistance.

Let's take a look at the basics first.




Look at the diagram above. As you can see, this zigzag pattern is making its way up (bull market). When the market moves up and then pulls back, the highest point reached before it pulled back is now resistance.

As the market continues up again, the lowest point reached before it started back is now support. In this way resistance and support are continually formed as the market oscillates over time. The reverse is true for the downtrend.

### *Plotting Support and Resistance*

One thing to remember is that support and resistance levels are **not exact numbers**.

Often times you will see a support or resistance level that appears broken, but soon after find out that the market was just testing it. With candlestick charts, these "tests" of support and resistance are usually represented by the candlestick shadows.

Notice how the shadows of the candles tested the 1.4700 support level. At those times it seemed like the market was "breaking" support. In hindsight we can see that the market was merely testing that level.

## *So how do we truly know if support and resistance was broken?*

There is no definite answer to this question. Some argue that a support or resistance level is broken if the market can actually close past that level. However, you will find that this is not always the case.

Let's take our same example from above and see what happened when the price actually closed past the 1.4700 support level.

In this case, price had closed below the 1.4700 support level but ended up rising back up above it.

If you had believed that this was a real breakout and sold this pair, you would've been seriously hurtin'!

Looking at the chart now, you can visually see and come to the conclusion that the support was not actually broken; it is still very much intact and now even stronger.

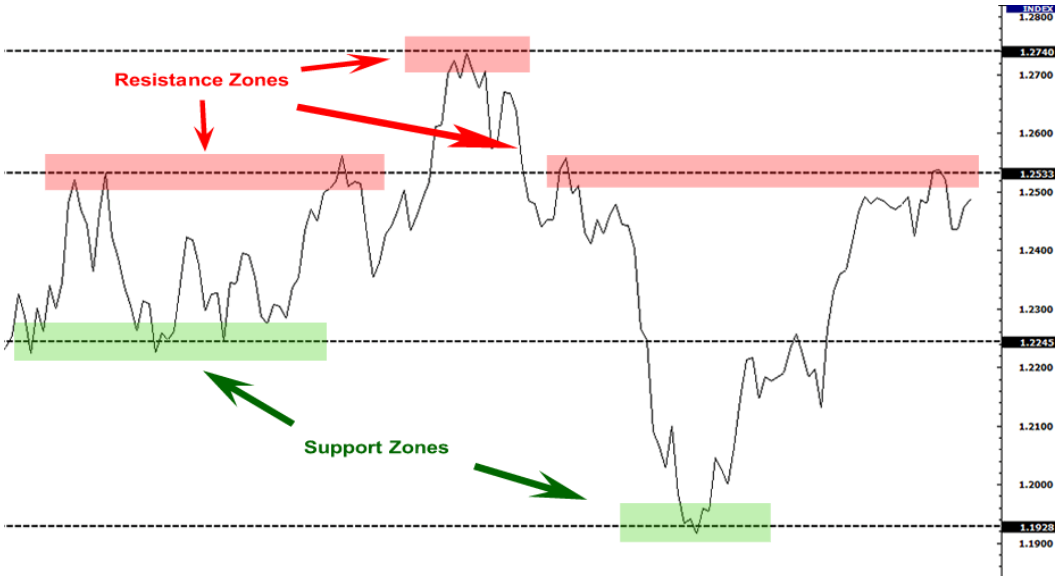
To help you filter out these false breakouts, you should think of support and resistance more of as "zones" rather than concrete numbers.

One way to help you find these zones is to plot support and resistance on a line chart rather than a candlestick chart. The reason is that line charts only show you the closing price while candlesticks add the extreme highs and lows to the picture.

These highs and lows can be misleading because often times they are just the "knee-jerk" reactions of the market. It's like when someone is doing something really strange, but when asked about it, he or she simply replies, "Sorry, it's just a reflex."

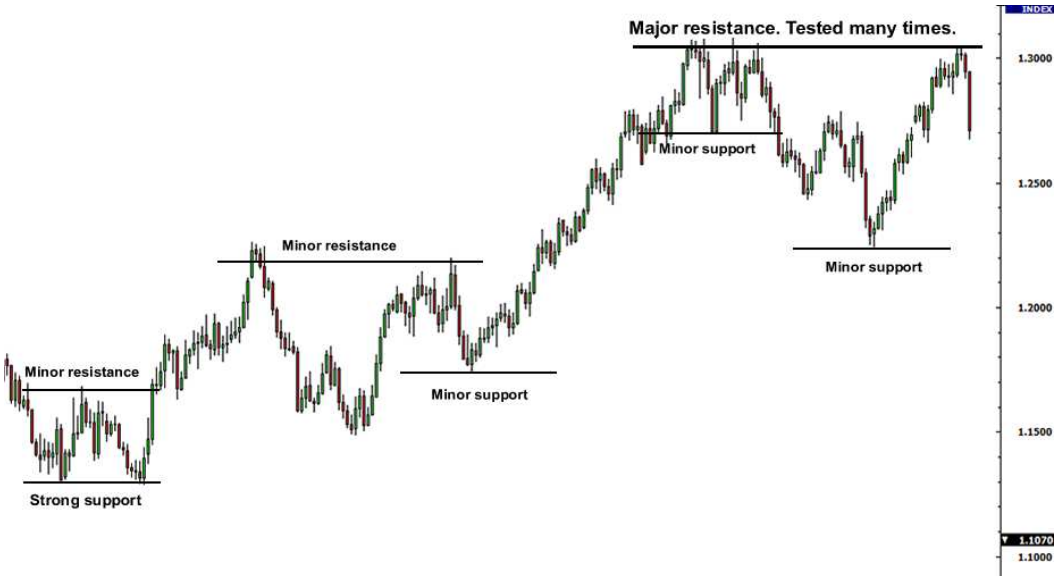
*When plotting support and resistance, you don't want the reflexes of the market. You only want to plot its intentional movements.*

Looking at the line chart, you want to plot your support and resistance lines around areas where you can see the price forming several peaks or valleys.




## *Other interesting tidbits about support and resistance:*

- When the price passes through resistance, that resistance could potentially become support.
- The more often price tests a level of resistance or support without breaking it, the stronger the area of resistance or support is.
- When a support or resistance level breaks, the strength of the follow-through move depends on how strongly the broken support or resistance had been holding.



With a little practice, you'll be able to spot potential support and resistance areas easily. In the next lesson, we'll teach you how to trade diagonal support and resistance lines, otherwise known as trend lines.

# Trend Lines

Trend lines are probably the most common form of technical analysis. They are probably one of the most underutilized ones as well.

If drawn correctly, they can be as accurate as any other method. Unfortunately, most traders don't draw them correctly or try to make the line fit the market instead of the other way around.

In their most basic form, an uptrend line is drawn along the bottom of easily identifiable support areas (valleys). In a downtrend, the trend line is drawn along the top of easily identifiable resistance areas (peaks).

### *How do you draw trend lines?*

To draw trend lines properly, all you have to do is locate two major tops or bottoms and connect them.

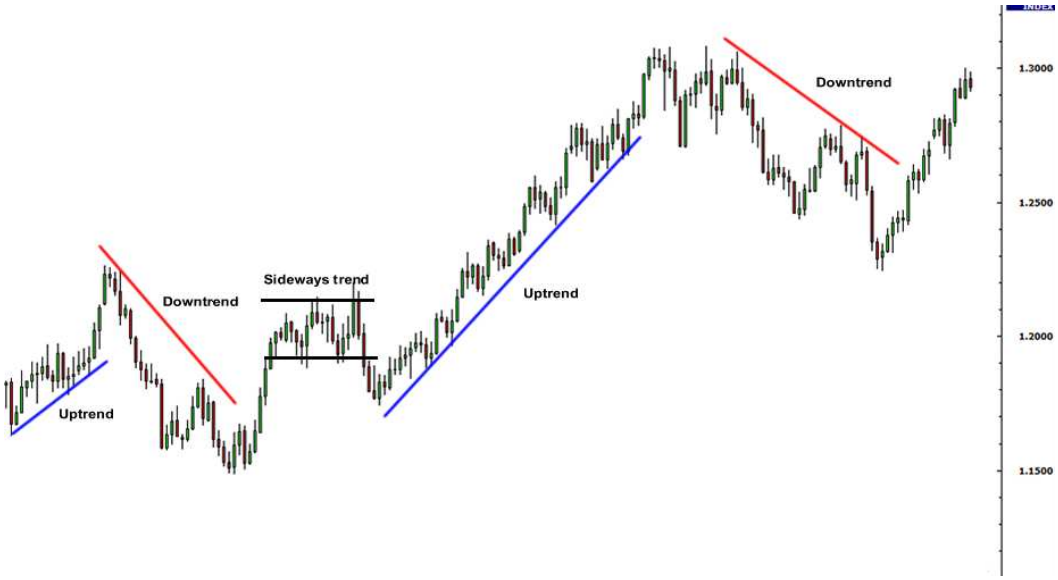
What's next?

Nothing.

Uhh, is that it?

Yep, it's that simple.

Here are trend lines in action! Look at those waves!




### *Types of Trends*

There are three types of trends:

1. Uptrend (higher lows)
2. Downtrend (lower highs)
3. Sideways trends (ranging)

### *Here are some important things to remember about trend lines:*

- It takes at least two tops or bottoms to draw a valid trend line but it takes THREE to confirm a trend line.
- The STEEPER the trend line you draw, the less reliable it is going to be and the more likely it will break.
- Like horizontal support and resistance levels, trend lines become stronger the more times they are tested.
- And most importantly, **DO NOT EVER** draw trend lines by forcing them to fit the market. If they do not fit right, then that trend line isn't a valid one!

# Channels

If we take this trend line theory one step further and draw a parallel line at the same angle of the uptrend or downtrend, we will have created a channel. No, we're not talking about ESPN, ABC, or Cartoon Network.

Still, this doesn't mean that you should walk away like it's a commercial break- channels can be just as exciting to watch as America's Next Top Model or Entourage!

Channels are just another tool in technical analysis which can be used to determine good places to buy or sell. Both the tops and bottoms of channels represent potential areas of support or resistance.

To create an up (ascending) channel, simply draw a parallel line at the same angle as an uptrend line and then move that line to position where it touches the most recent peak. This should be done at the same time you create the trend line.

To create a down (descending) channel, simply draw a parallel line at the same angle as the downtrend line and then move that line to a position where it touches the most recent valley. This should be done at the same time you create the trend line.

When prices hit the bottom trend line, this may be used as a buying area. When prices hit the upper trend line, this may be used as a selling area.

## *Types of channels*

There are three types of channels:

1. Ascending channel (higher highs and higher lows)
2. Descending channel (lower highers and lower lows)

Horizontal channel (ranging)

### *Important things to remember about trend lines:*

- When constructing a channel, both trend lines must be parallel to each other.
- Generally, the bottom of channel is considered a buy zone while the top of channel is considered a sell zone.
- Like in drawing trend lines, **DO NOT EVER** force the price to the channels that you draw! A channel boundary that is sloping at one angle while the corresponding channel boundary is sloping at another is not correct and could lead to bad trades.

# Trading the Lines

Now that you know the basics, it's time to apply these basic but extremely useful technical tools in your trading. Because here at BabyPips.com we want to make things easy to understand, we have divided trading support and resistance levels into two simple ideas: the Bounce and the Break.

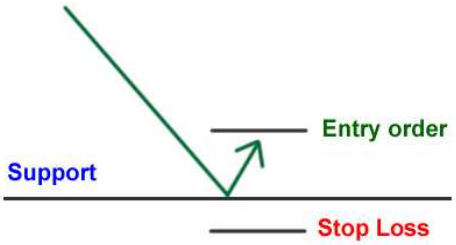
### *The Bounce*

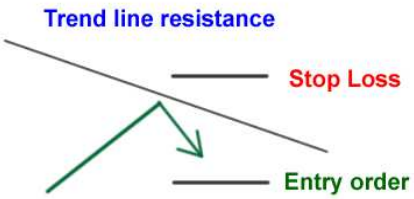
As the name suggests, one method of trading support and resistance levels is right after the bounce.

Many retail traders make the error of setting their orders directly on support and resistance levels and then just waiting to for their trade to materialize. Sure, this may work at times but this kind of trading method assumes that a support or resistance level will hold without price actually getting there yet.

You might be thinking, "Why don't I just set an entry order right on the line? That way, I am assured the best possible price."

When playing the bounce we want to tilt the odds in our favor and find some sort of confirmation that the support or resistance will hold. Instead of simply buying or selling right off the bat, wait for it to bounce first before entering. By doing this, you avoid those moments where price moves fast and break through support and resistance levels. From experience, catching a falling knife can get really bloody...




## *The Break*

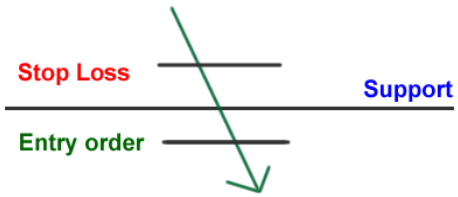
In a perfect world, support and resistance levels would hold forever, McDonalds would be healthy, and we'd all have jetpacks. In a perfect trading world, we could just jump in and out whenever price hits those major support and resistance levels and earn loads of money. The fact of the matter is that these levels break... often.

So, it's not enough to just play bounces. You should also know what to do whenever support and resistance levels give way! There are two ways to play breaks: the aggressive way or the conservative way.

## *The Aggressive Way*

The simplest way to play breakouts is to buy or sell whenever price passes convincingly through a support or resistance zone. The key word here is convincingly because we only want to enter when price passes through a significant support or resistance level with ease.

We want the support or resistance area to act as if it just received a Chuck Norris karate chop: We want it to wilt over in pain as price breaks right through it.



## *The Conservative Way*

Imagine this hypothetical situation: you decided to go long EUR/USD hoping it would rise after bouncing from a support level. Soon after, support breaks and you are now holding on to a losing position, with your account balance slowly falling.

Do you...

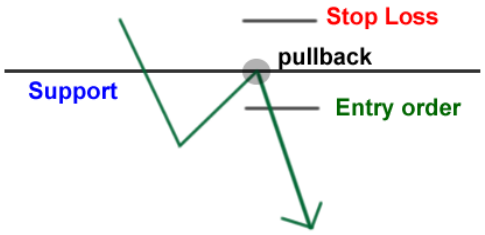
1. Accept defeat, get the heck out, and liquidate your position?

   OR

2. Hold on to your trade and hope price rises up again?

If your choice is the second one, then you will easily understand this type of trading method. Remember, whenever you close out a position, you take the opposite side of the trade. Closing your EUR/USD long trade at or near breakeven means you will have to short the EUR/USD by the same amount. Now, if enough selling and liquidiation of losing postions happen at the broken support level, price will reverse and start falling again. This phenomenon is the main reason why broken support levels become resistance whenever they break.

As you would've guessed, taking advantage of this phenomenon is all about being patient. Instead of entering right on the break, you wait for price to make a "pullback" to the broken support or resistance level and enter after the price bounces.




**A few words of caution... THIS DOES NOT HAPPEN ALL THE TIME. "RETESTS" OF BROKEN SUPPORT AND RESISTANCE LEVELS DO NOT HAPPEN ALL THE TIME. THERE WILL BE TIMES THAT PRICE WILL JUST MOVE IN ONE DIRECTION AND LEAVE YOU BEHIND. BECAUSE OF THIS, ALWAYS USE STOP LOSS ORDERS AND NEVER EVER HOLD ON TO A TRADE JUST BECAUSE OF HOPE.**

Whoops, sorry about that folks, the caps lock key got stuck.

# Summary: Support and Resistance

When the market moves up and then pulls back, the highest point reached before it pulls back is now resistance.

As the market continues up again, the lowest point reached before it climbs back is now support.

One thing to remember is that horizontal support and resistance levels are not exact numbers.

To help you filter out these false breakouts, you should think of support and resistance more of as "zones" rather than concrete numbers.

One way to help you find these zones is to plot support and resistance on a line chart rather than a candlestick chart.

Another thing to remember is that when price passes through a resistance level, that resistance could potentially become support. The same could also happen with a support level. If a support level is broken, it could potentially become a resistance level

## *Trend Lines*

In their most basic form, an uptrend line is drawn along the bottom of easily identifiable support areas (valleys). In a downtrend, the trend line is drawn along the top of easily identifiable resistance areas (peaks).

There are three types of trends:

1. Uptrend (higher lows)
2. Downtrend (lower highs)
3. Sideways trends (ranging)

## *Channels*

To create an up (ascending) channel, simply draw a parallel line at the same angle as an uptrend line and then move that line to position where it touches the most recent peak.

To create a down (descending) channel, simple draw a parallel line at the same angle as the downtrend line and then move that line to a position where it touches the most recent valley.

1. Ascending channel (higher highs and higher lows)
2. Descending channel (lower highers and lower lows)

3. Horizontal channel (ranging)

Trading support and resistance levels can be divided into two methods: the bounce and the break.

When trading **the bounce** we want to tilt the odds in our favor and find some sort of confirmation that the support or resistance will hold. Instead of simply buying or selling right off the bat, wait for it to bounce first before entering. By doing this, you avoid those moments where price moves so fast that it slices through support and resistance levels like a knife slicing through warm butter.

As for trading **the break**, there is the aggressive way and there is the conservative way. In the aggressive way, you simply buy or sell whenever the price passes through a support or resistance zone with ease. In the conservative way, you wait for price to make a "pullback" to the broken support or resistance level and enter after price bounces.

# What is a Japanese Candlestick?

## *What is a Japanese Candlestick?*

While we briefly covered candlestick charting analysis in the previous lesson, we'll now dig in a little and discuss them more in detail. Let's do a quick review first.

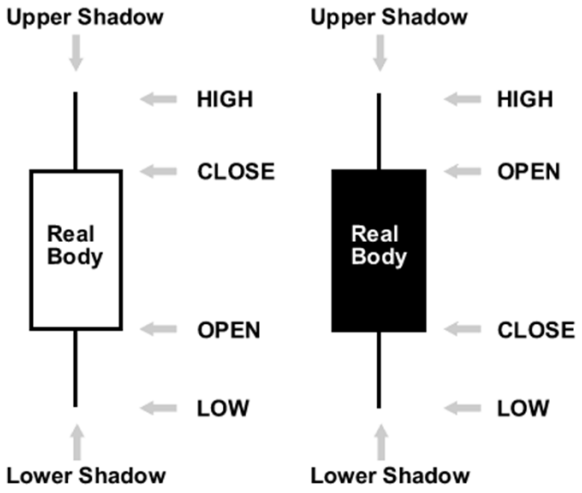
## *What is Candlestick Trading?*

Back in the day when Godzilla was still a cute little lizard, the Japanese created their own old school version of technical analysis to trade rice. That's right, rice.

A westerner by the name of Steve Nison "discovered" this secret technique called "Japanese candlesticks", learning it from a fellow Japanese broker. Steve researched, studied, lived, breathed, ate candlesticks, and began to write about it. Slowly, this secret technique grew in popularity in the 90s. To make a long story short, without Steve Nison, candlestick charts might have remained a buried secret. Steve Nison is Mr. Candlestick.

## *Okay, so what the heck are forex candlesticks?*

The best way to explain is by using a picture:




Candlesticks can be used for any time frame, whether it be one day, one hour, 30-minutes - whatever you want! Candlesticks are used to describe the price action during the given time frame.

Candlesticks are formed using the open, high, low, and close of the chosen time period.

- If the close is above the open, then a hollow candlestick (usually displayed as white) is drawn.
- If the close is below the open, then a filled candlestick (usually displayed as black) is drawn.
- The hollow or filled section of the candlestick is called the "real body" or body.
- The thin lines poking above and below the body display the high/low range and are called shadows.
- The top of the upper shadow is the "high".
- The bottom of the lower shadow is the "low".

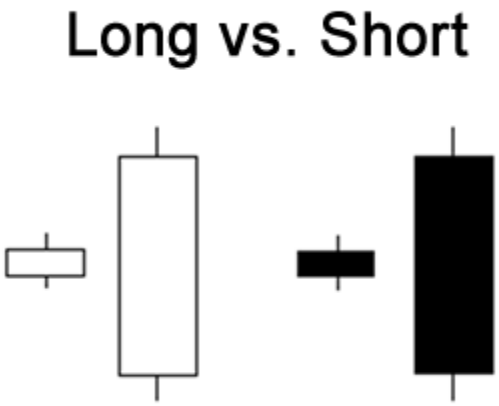
# Sexy Bodies and Strange Shadows

## *Sexy Bodies*

Just like humans, candlesticks have different body sizes. And when it comes to forex trading, there's nothing naughtier than checking out the bodies of candlesticks!

Long bodies indicate strong buying or selling. The longer the body is, the more intense the buying or selling pressure. This means that either buyers or sellers were stronger and took control.

Short bodies imply very little buying or-selling activity. In street forex lingo, bulls mean buyers and bears mean sellers.




Long white candlesticks show strong buying pressure. The longer the white candlestick, the further the close is above the open. This indicates that prices increased considerably from open to close and buyers were aggressive. In other words, the bulls are kicking the bears' butts big time!

Long black (filled) candlesticks show strong selling pressure. The longer the black candlestick, the further the close is below the open. This indicates that prices fell a great deal from the open and sellers were aggressive. In other words, the bears were grabbing the bulls by their horns and body-slamming them.

## *Mysterious Shadows*

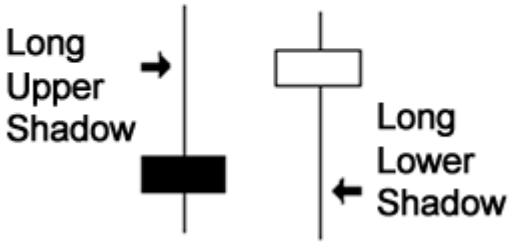
The upper and lower shadows on candlesticks provide important clues about the trading session.

Upper shadows signify the session high. Lower shadows signify the session low.

Candlesticks with long shadows show that trading action occurred well past the open and close.

Candlesticks with short shadows indicate that most of the trading action was confined near the open and close.

## Long Shadows




If a candlestick has a *long upper shadow and short lower shadow*, this means that buyers flexed their muscles and bid prices higher, but for one reason or another, sellers came in and drove prices back down to end the session back near its open price.

If a candlestick has a *long lower shadow and short upper shadow*, this means that sellers flashed their washboard abs and forced price lower, but for one reason or another, buyers came in and drove prices back up to end the session back near its open price.

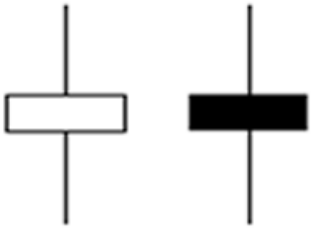
# Basic Candlestick Patterns

### *Spinning Tops*

Candlesticks with a long upper shadow, long lower shadow and small real bodies are called spinning tops. The color of the real body is not very important.

The pattern indicates the **indecision** between the buyers and sellers.

Spinning Tops



The small real body (whether hollow or filled) shows little movement from open to close, and the shadows indicate that both buyers and sellers were fighting but nobody could gain the upper hand.

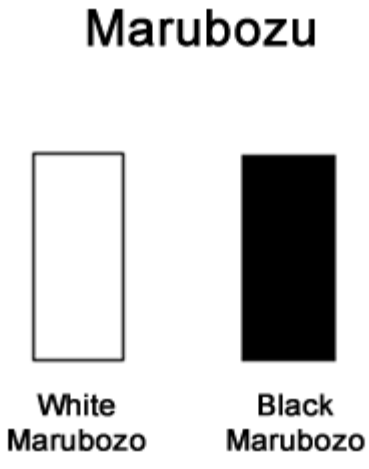
Even though the session opened and closed with little change, prices moved significantly higher and lower in the meantime. Neither buyers nor sellers could gain the upper hand, and the result was a standoff.

If a spinning top forms during an uptrend, this usually means there aren't many buyers left and a possible reversal in direction could occur.

If a spinning top forms during a downtrend, this usually means there aren't many sellers left and a possible reversal in direction could occur.

### *Marubozu*

Sounds like some kind of voodoo magic, huh? "I will cast the evil spell of the Marubozu on you!" Fortunately, that's not what it means. Marubozu means there are no shadows from the bodies. Depending on whether the candlestick's body is filled or hollow, the high and low are the same as its open or close. Check out the two types of Marubozus in the picture below.




A **White Marubozu** contains a long white body with no shadows. The **open price equals the low price** and the **close price equals the high price**. This is a very bullish candle as it shows that buyers were in control the entire session. It usually becomes the first part of a bullish continuation or a bullish reversal pattern.

A **Black Marubozu** contains a long black body with no shadows. The **open equals the high** and the **close equals the low**. This is a very bearish candle as it shows that sellers controlled the price action the entire session. It usually implies bearish continuation or bearish reversal.

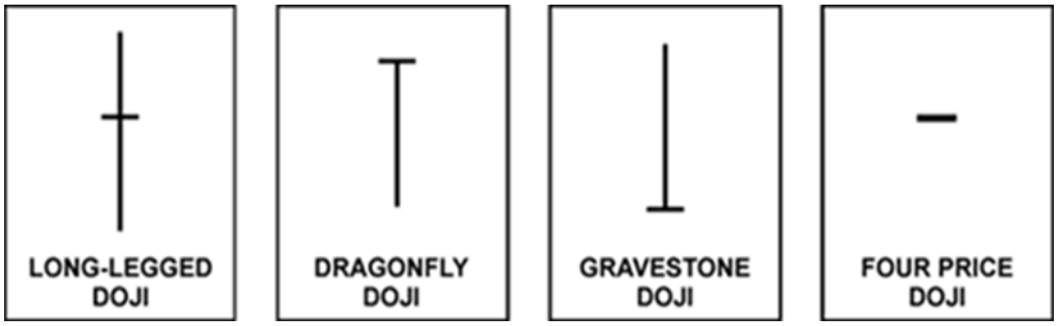
## *Doji*

**Doji candlesticks** have the **same open and close price** or at least their bodies are extremely short. A doji should have a very small body that appears as a thin line.

Doji candles suggest indecision or a struggle for turf positioning between buyers and sellers. Prices move above and below the open price during the session, but close at or very near the open price.

Neither buyers nor sellers were able to gain control and the result was essentially a draw.

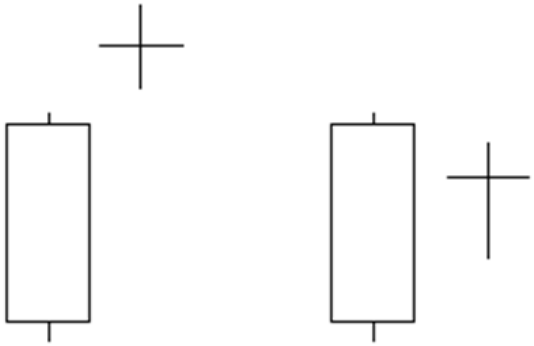
There are four special types of Doji candlesticks. The length of the upper and lower shadows can vary and the resulting candlestick looks like a cross, inverted cross or plus sign. The word "Doji" refers to both the singular and plural form.




When a Doji forms on your chart, pay special attention to the preceding candlesticks.

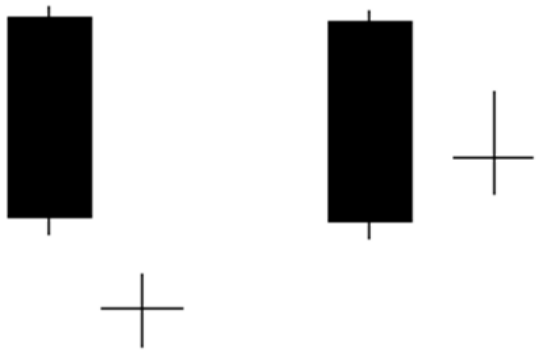
If a Doji forms after a series of candlesticks with long hollow bodies (like White Marubozus), the Doji signals that the buyers are becoming exhausted and weakening. In order for price to continue rising, more buyers are needed but there aren't anymore! Sellers are licking their chops and are looking to come in and drive the price back down.

## Long White Candle + Doji



If a Doji forms after a series of candlesticks with long filled bodies (like Black Marubozus), the Doji signals that sellers are becoming exhausted and weak. In order for price to continue falling, more sellers are needed but sellers are all tapped out! Buyers are foaming in the mouth for a chance to get in cheap.

## Long Black Candle + Doji



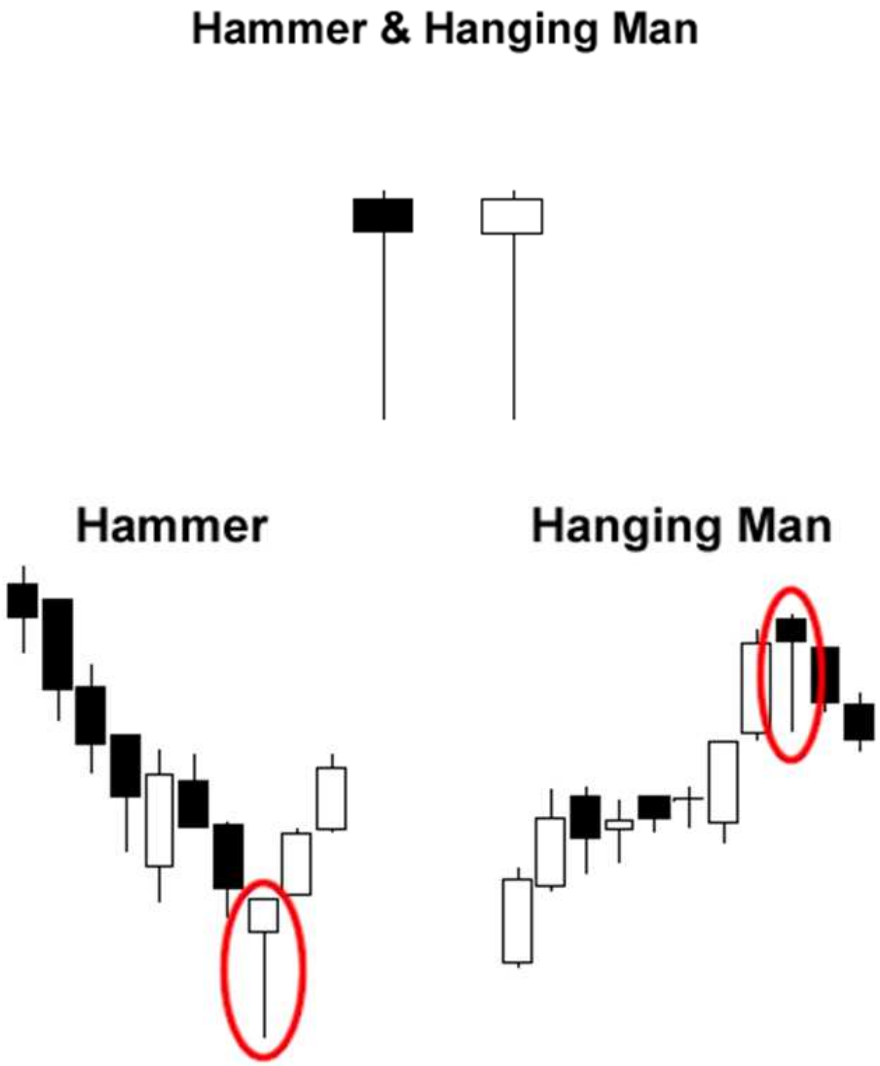
While the decline is sputtering due to lack of new sellers, further buying strength is required to confirm any reversal. Look for a white candlestick to close above the long black candlestick's open.

In the next following sections, we will take a look at specific candlestick formations and what they are telling us. Hopefully, by the end of this lesson on candlesticks, you would know how to recognize candlestick patterns and make sound trading decisions based on them.

# Lone Rangers - Single Candlestick Patterns

## *Hammer and Hanging Man*

The hammer and hanging man look exactly alike but have totally different meanings depending on past price action. Both have cute little bodies (black or white), long lower shadows, and short or absent upper shadows.




The **hammer** is a bullish reversal pattern that forms during a downtrend. It is named because the market is hammering out a bottom.

When price is falling, hammers signal that the bottom is near and price will start rising again. The long lower shadow indicates that sellers pushed prices lower, but buyers were able to overcome this selling pressure and closed near the open.

Just because you see a hammer form in a downtrend doesn't mean you automatically place a buy order! More bullish confirmation is needed before it's safe to pull the trigger.

A typical example of confirmation would be to wait for a white candlestick to close above the open to the right side of the hammer.

Recognition Criteria:

- The long shadow is about two or three times of the real body.
- Little or no upper shadow.
- The real body is at the upper end of the trading range.
- The color of the real body is not important.

The **hanging man** is a bearish reversal pattern that can also mark a top or strong resistance level. When price is rising, the formation of a hanging man indicates that sellers are beginning to outnumber buyers.

The long lower shadow shows that sellers pushed prices lower during the session. Buyers were able to push the price back up some but only near the open.

This should set off alarms since this tells us that there are no buyers left to provide the necessary momentum to keep raising the price.

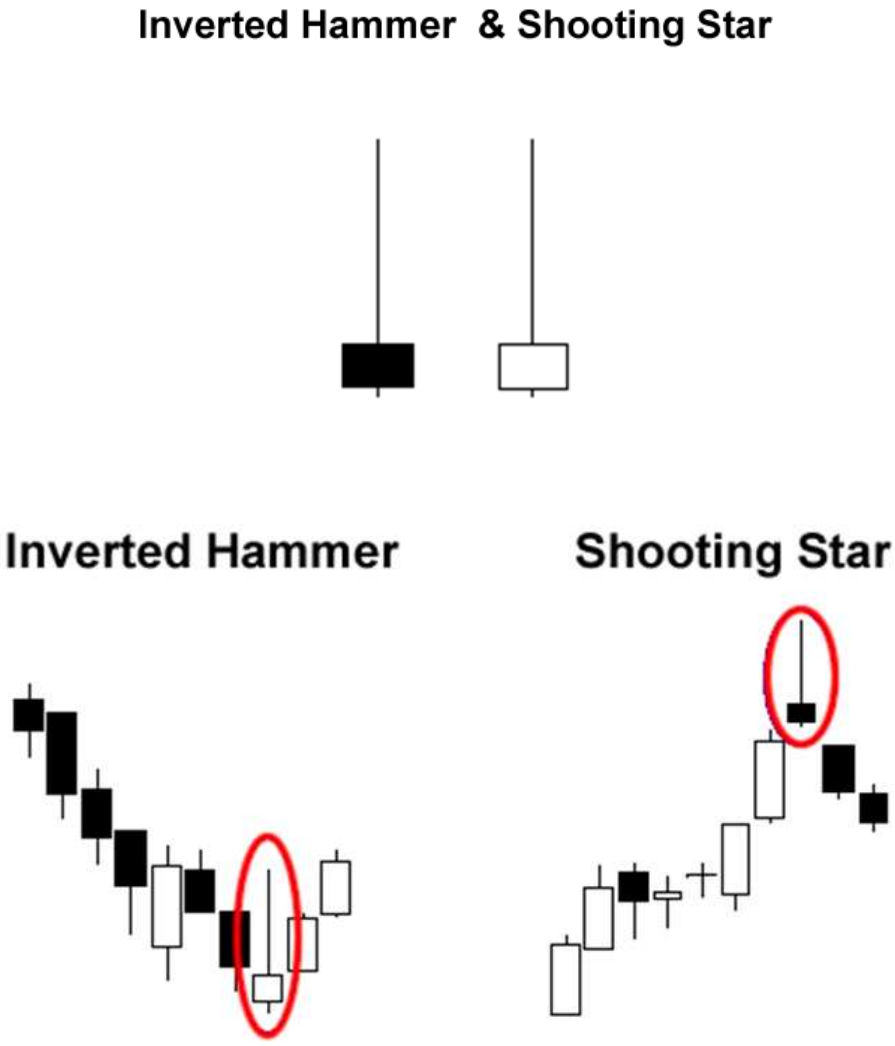
Recognition Criteria:

- A long lower shadow which is about two or three times of the real body.
- Little or no upper shadow.
- The real body is at the upper end of the trading range.

The color of the body is not important, though a black body is more bearish than a white body.

## *Inverted Hammer and Shooting Star*

The inverted hammer and shooting star also look identical. The only difference between them is whether you're in a downtrend or uptrend. Both candlesticks have petite little bodies (filled or hollow), long upper shadows, and small or absent lower shadows.




The **inverted hammer** occurs when price has been falling suggests the possibility of a reversal. Its long upper shadow shows that buyers tried to bid the price higher.

However, sellers saw what the buyers were doing, said "Oh heck no" and attempted to push the price back down.

Fortunately, the buyers had eaten enough of their Wheaties for breakfast and still managed to close the session near the open.

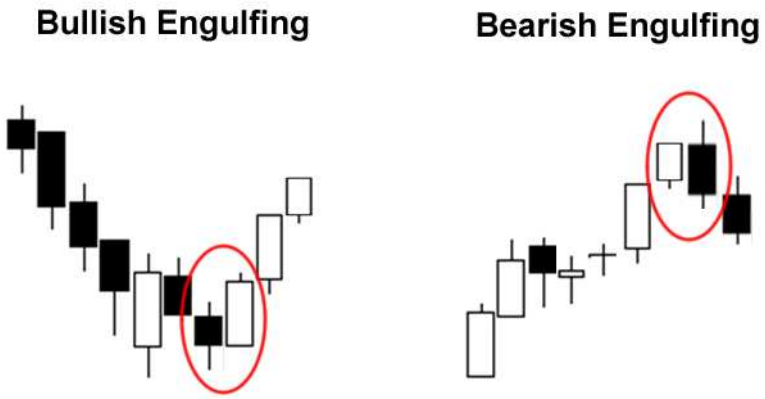
Since the sellers weren't able to close the price any lower, this is a good indication that everybody who wants to sell has already sold. And if there are no more sellers, who is left? Buyers.

The **shooting star** is a bearish reversal pattern that looks identical to the inverted hammer but occurs when price has been rising. Its shape indicates that the price opened at its low, rallied, but pulled back to the bottom.

This means that buyers attempted to push the price up, but sellers came in and overpowered them. This is a definite bearish sign since there are no more buyers left because they've all been murdered.

# Double Trouble - Dual Candlestick Patterns

## *Engulfing Candles*




The **bullish engulfing pattern** is a two candle stick pattern that signals a strong up move may be coming. It happens when a bearish candle is immediately followed by a larger bullish candle.

This second candle "engulfs" the bearish candle. This means buyers are flexing their muscles and that there could be a strong up move after a recent downtrend or a period of consolidation.

On the other hand, the **bearish engulfing pattern** is the opposite of the bullish pattern. This type of pattern occurs when bullish candle is immediately followed by a bearish

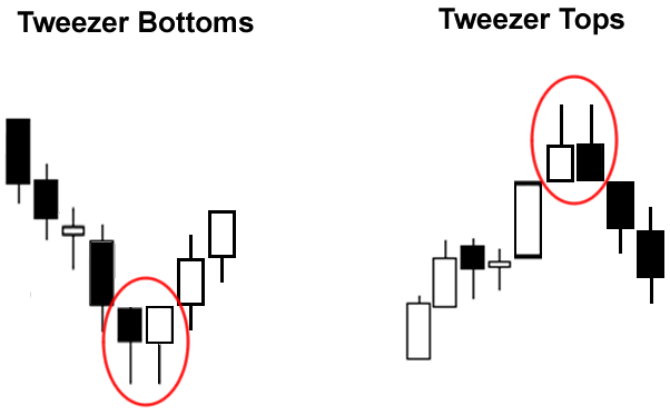
candle that completely "engulfs" it. This means that sellers overpowered the buyers and that a strong move down could happen.

### *Tweezer Bottoms and Tops*

The tweezers are dual candlestick reversal patterns. This type of candlestick pattern could usually be spotted after an extended up trend or downtrend, indicating that a reversal will soon occur.

Notice how the candlestick formation looks just like a pair of tweezers!

Amazing!

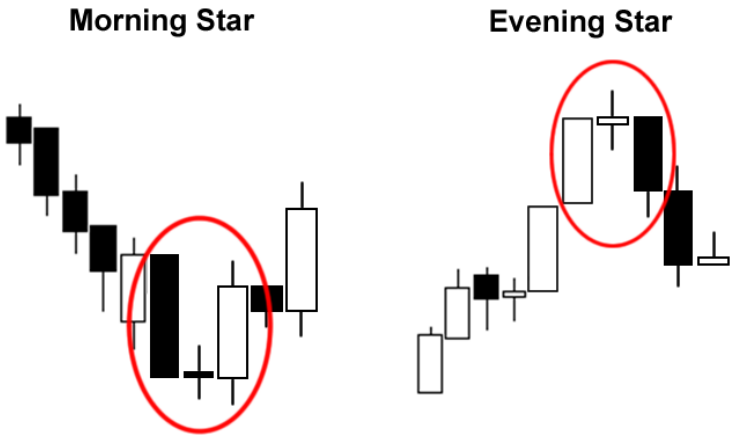



The most effective tweezers have the following characteristics:

- The first candle is the same as the overall trend. If price is moving up, then the first candle should be bullish.
- The second candle is opposite the overall trend. If price is moving up, then the second candle should be bearish.
- The shadows of the candles should be of equal length. Tweezer tops should have the same highs, while tweezer bottoms should have the same lows.

# Three's Not A Crowd - Triple Candlestick Patterns

***Evening and Morning Stars***




The **three inside up** candlestick formation is a trend-reversal pattern that is found at the bottom of a downtrend. It indicates that the downtrend is possibly over and that a new uptrend has started. For a valid three inside up candlestick formation, look for these properties:

1. The first candle should be found at the bottom of a downtrend and is characterized by a long bearish candlestick.
2. The second candle should at least make it up all the way up to the midpoint of the first candle.
3. The third candle needs to close above the first candle's high to confirm that buyers have overpowered the strength of the downtrend.

Conversely, the **three inside down** candlestick formation is found at the top of an uptrend. It means that the uptrend is possibly over and that a new downtrend has started. A three inside down candle stick formation needs have the following characteristics:

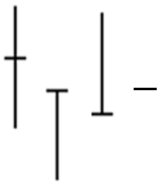
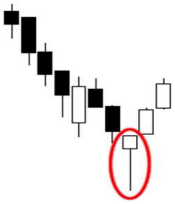
1. The first candle should be found at the top of an uptrend and is characterized by a long bullish candlestick.
2. The second candle should make it up all the way down the midpoint of the first candle.
3. The third candle needs to close below the first candle's low to confirm that sellers have overpowered the strength of the uptrend.

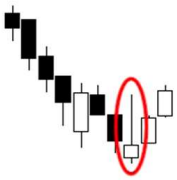
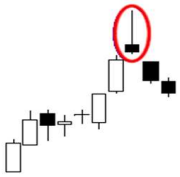
# Japanese Candlesticks Cheat Sheet

Did you click here first? If you did, stop reading right now and go through the entire Japanese Candlesticks Lesson first!

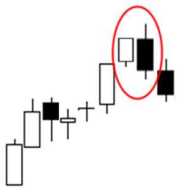
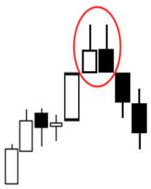
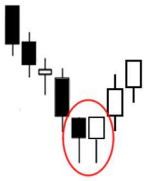
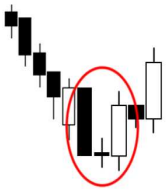
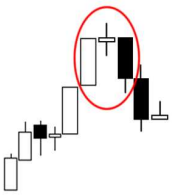
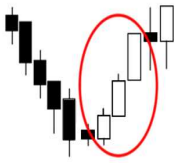
If you're REALLY done with those, here's quick one page reference cheat sheet for single, dual, and triple candlestick formations to easily identify what kind of pattern you are looking at whenever you are trading.

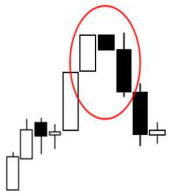
Go ahead and bookmark this page... No need to be shy!

| Number of Bars | Name | Bullish or Bearish? | What It Looks Like? |
|---|---|---|---|
| Single | Spinning Top | Neutral | |
| | Doji | Neutral |  |
| | White Marubozu | Bullish | |
| | Black Marubozu | Bearish | |
| | Hammer | Bullish |  |

| | | |
|---|---|---|
| Hanging Man | Bearish | |
| Inverted Hammer | Bullish |  |
| Shooting Star | Bearish |  |

| Number of Bars | Name | Bullish or Bearish? | What it Looks Like? |
|---|---|---|---|
| **Double** | Bullish Engulfing | Bullish | |

| | | | |
|---|---|---|---|
| | Bearish Engulfing | Bearish |  |
| | Tweezer Tops | Bearish |  |
| | Tweezer Bottoms | Bullish |  |
| **Triple** | Morning Star | Bullish |  |
| | Evening Star | Bearish |  |
| | Three White Soldiers | Bullish |  |
| | Three Black Crows | Bearish | |
| | Three Inside Up | Bullish | |

| | | |
|---|---|---|
| Three Inside Down | Bearish |  |

# Summary: Japanese Candlesticks

- If the close is above the open, then a hollow candlestick (usually displayed as white) is drawn.
- If the close is below the open, then a filled candlestick (usually displayed as black) is drawn.
- The hollow or filled section of the candlestick is called the "real body" or body.
- The thin lines poking above and below the body display the high/low range and are called shadows.
- The top of the upper shadow is the "high".
- The bottom of the lower shadow is the "low".

Long bodies indicate strong buying or selling. The longer the body is, the more intense the buying or selling pressure.

Short bodies imply very little buying or selling activity. In street forex lingo, bulls mean buyers and bears mean sellers.

Upper shadows signify the session high.

Lower shadows signify the session low.

There are many types of candlestick patterns, but they can be categorized into how many bars make up the candlestick pattern. There are single, dual, and triple candlestick formations. The most common types of candlestick patterns are the following:

| Number of Bars | Candlestick Pattern |
|---|---|
| Single | Spinning Tops, Dojis, Marubozu, Inverted Hammer, Hanging Man, Shooting Star |
| Double | Bullish and Bearish Engulfing, Tweezer Tops and Bottoms |
| Triple | Morning and Evening Stars, Three Black Crows and Three White Soldiers, Three Inside Up and Down |

Just refer to the Candlestick Cheat Sheet for a quick reference on what these candlestick patterns mean.

Combine candlestick analysis with support and resistance levels for best results.

And finally, here are some words of wisdom.

Just because candlesticks hint at a reversal or continuation, it doesn't mean it will happen for sure! You must always consider market conditions and what price action is telling you.

This is the forex market and nothing is set in stone!

# Fibonacci Who?

We will be using Fibonacci ratios a lot in our trading so you better learn it and love it like your mother's home cooking. Fibonacci is a huge subject and there are many different Fibonacci studies with weird-sounding names but we're going to stick to two: retracement and extension.

Let us first start by introducing you to the Fib man himself...Leonardo Fibonacci.

No, Leonardo Fibonacci isn't some famous chef. Actually, he was a famous Italian mathematician, also known as a super duper uber ultra geek.

He had an "Aha!" moment when he discovered a simple series of numbers that created ratios describing the natural proportions of things in the universe.

The ratios arise from the following number series: 1, 1, 2, 3, 5, 8, 13, 21, 34, 55, 89, 144...

This series of numbers is derived by starting with 1 followed by 2 and then adding 1 + 2 to get 3, the third number. Then, adding 2 + 3 to get 5, the fourth number, and so on.

After the first few numbers in the sequence, if you measure the ratio of any number to the succeeding higher number, you get .618. For example, 34 divided by 55 equals .618.

If you measure the ratio between alternate numbers you get .382. For example, 34 divided by 89 = 0.382 and that's as far as into the explanation as we'll go.

These ratios are called the "golden mean". Okay that's enough mumbo jumbo. With all those numbers, you could put an elephant to sleep. We'll just cut to the chase; these are the ratios you HAVE to know:

**Fibonacci Retracement Levels**
0.236, 0.382, 0.500, 0.618, 0.764

**Fibonacci Extension Levels**
0, 0.382, 0.618, 1.000, 1.382, 1.618

You won't really need to know how to calculate all of this. Your charting software will do all the work for you. Besides, we've got a nice Fibonacci calculator that can magically calculate those levels for you. However, it's always good to be familiar with the basic theory behind the indicator so you'll have the knowledge to impress your date.

Traders use the Fibonacci retracement levels as potential **support and resistance areas**. Since so many traders watch these same levels and place buy and sell orders on them to enter trades or place stops, the support and resistance levels tend to become a self-fulfilling prophecy.

Traders use the Fibonacci extension levels as **profit taking levels**. Again, since so many traders are watching these levels to place buy and sell orders to take profits, this tool tends to work more often than not due to self-fulfilling expectations.

Most charting software includes both Fibonacci retracement levels and extension level tools. In order to apply Fibonacci levels to your charts, you'll need to identify Swing High and Swing Low points.

A Swing High is a candlestick with at least two lower highs on both the left and right of itself.

A Swing Low is a candlestick with at least two higher lows on both the left and right of itself.

You got all that? Don't worry, we'll explain retracements, extensions, and most importantly, how to grab some pips using the Fib tool in the following sections.

# Fibonacci Retracement

The first thing you should know about the Fibonacci tool is that it works best when the market is trending.

The idea is to go long (or buy) on a retracement at a Fibonacci support level when the market is trending up, and to go short (or sell) on a retracement at a Fibonacci resistance level when the market is trending down.

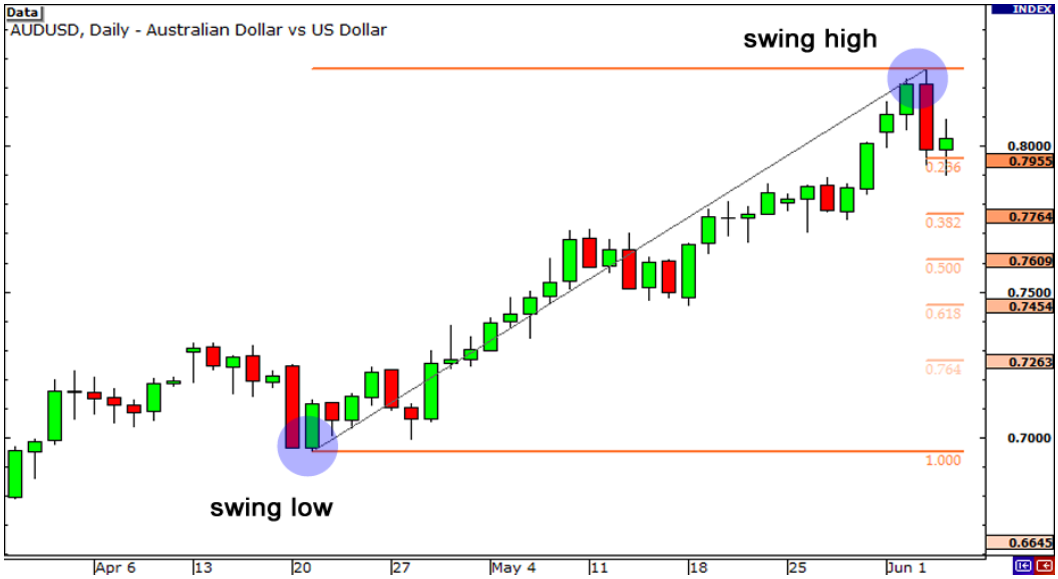
In order to find these retracement levels, you have to find the recent significant Swing Highs and Swings Lows. Then, for downtrends, click on the Swing High and drag the cursor to the most recent Swing Low.

For uptrends, do the opposite. Click on the Swing Low and drag the cursor to the most recent Swing High.

Got that? Now, let's take a look at some examples on how to apply Fibonacci retracements levels in the markets.

## *Uptrend*

This is a daily chart of AUD/USD.




Here we plotted the Fibonacci retracement Levels by clicking on the Swing Low at .6955 on April 20 and dragging the cursor to the Swing High at .8264 on June 3. Tada! The software magically shows you the retracement levels.

As you can see from the chart, the retracement levels were .7955 (23.6%), .7764 (38.2%), .7609 (50.0%), .7454 (61.8%), and .7263 (76.4%).

Now, the expectation is that if AUD/USD retraces from the recent high, it will find support at one of those Fibonacci levels because traders will be placing buy orders at these levels as price pulls back.

Now, let's look at what happened after the Swing High occurred.

Price pulled back right through the 23.6% level and continued to shoot down over the next couple of weeks. It even tested the 38.2% level but was unable to close below it.

Later on, around July 14, the market resumed its upward move and eventually broke through the swing high. Clearly, buying at the 38.2% Fibonacci level would have been a profitable long term trade!

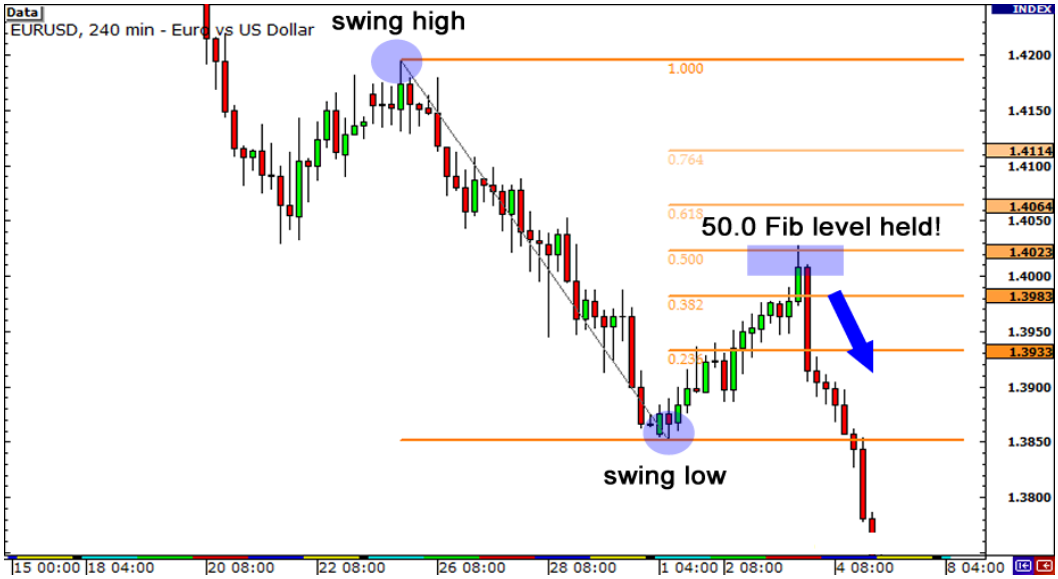
## *Downtrend*

Now, let's see how we would use the Fibonacci retracement tool during a downtrend. Below is a 4-hour chart of EUR/USD.

As you can see, we found our Swing High at 1.4195 on January 26 and our Swing Low at 1.3854 a few days later on February 2. The retracement levels are 1.3933 (23.6%), 1.3983 (38.2%), 1.4023 (50.0%), 1.4064 (61.8%) and 1.4114 (76.4%).

The expectation for a downtrend is that if price retraces from this low, it will encounter resistance at one of the Fibonacci levels because traders will be ready with sell orders there.

Let's take a look at what happened next.




Yowza, isn't that a thing of beauty?! T

he market did try to rally, stalled below the 38.2% level for a bit before testing the 50.0% level. If you had some orders either at the 38.2% or 50.0% levels, you would've made some mad pips on that trade.

In these two examples, we see that price *found* some temporary support or resistance at Fibonacci retracement levels. Because of all the people who use the Fibonacci tool, those levels become self-fulfilling support and resistance levels.

One thing you should take note of is that price won't always bounce from these levels. They should be looked at as *areas of interest*, or as Cyclopip likes to call them, "**KILL ZONES!**" We'll teach you more about that later on.

For now, there's something you should always remember about using the Fibonacci tool and it's that they are not always simple to use! If they were that simple, traders would always place their orders at Fib levels and the markets would trend forever.

In the next lesson, we'll show you what can happen when Fibonacci levels fail.

# When Fibonacci Fails

Back in Grade 1, we said that support and resistance levels eventually break. Well, seeing as how Fibonacci levels are used to find support and resistance levels, this also applies to Fibonacci!

Now, let's go through an example when the Fibonacci retracement tool fails.

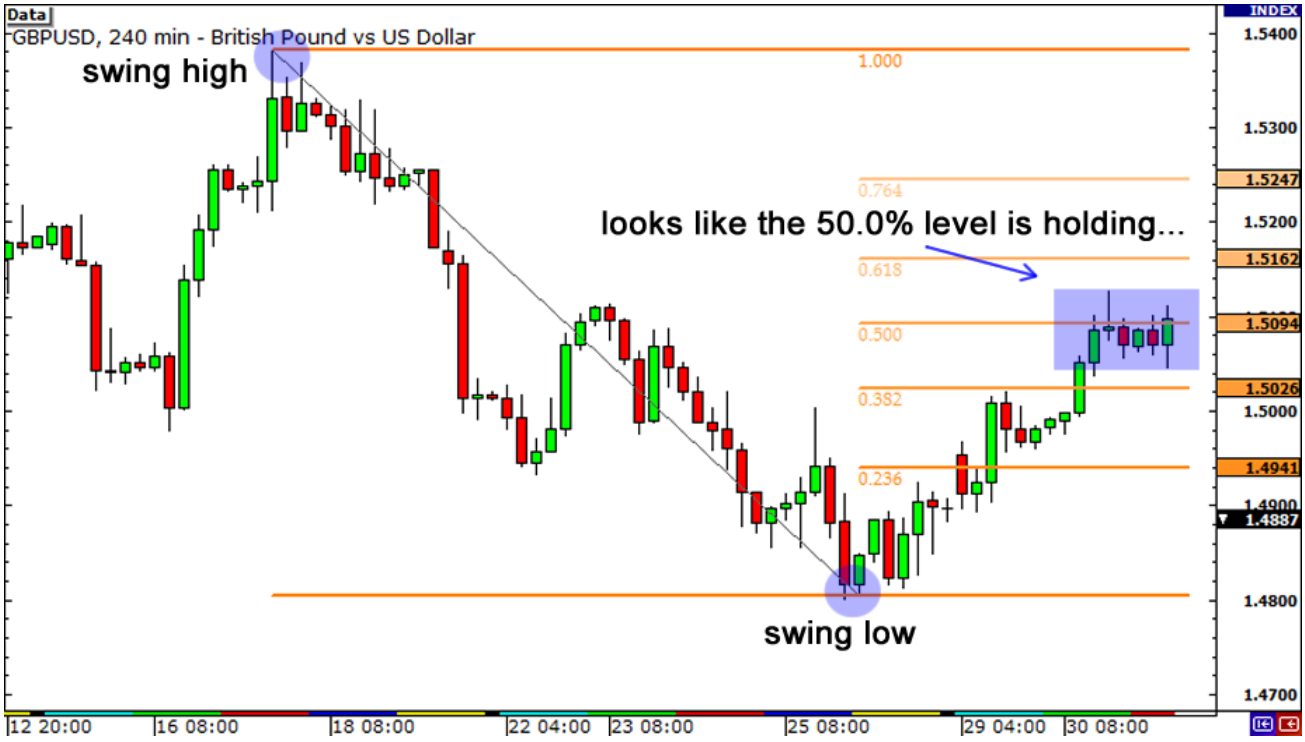
Below is a 4-hour chart of GBP/USD.

Here, you see that the pair has been in downtrend, so you decided to take out your Fibonacci tool to help you spot a good entry point. You use the Swing High at 1.5383, with a swing low at 1.4799.

You see that the pair has been stalling at the 50.0% level for the past couple of candles.

You say to yourself, "Oh man, that 50.0% Fib level! It's holding baby! Time to short this sucka!"

You short at market and start day dreaming that you'll be driving down Rodeo Drive in your new Maserati with Scarlett Johansson (or if you're a lady trader, Robert Pattinson) in the passenger seat...




Now, if you really did put an order at that level, not only would your dreams go up in smoke, but your account would take a serious hit if you didn't manage your risk properly!

Take a look at what happened.

It turns out that that Swing Low was the bottom of the downtrend and market began to rally above the Swing High point.

What's the lesson here?

While Fibonacci levels give you a higher probability of success, like other technical tools, they don't always work. You don't know if price will reverse to the 38.2% level before resuming the trend.

Sometimes it may hit 50.0% or the 61.8% levels before turning around. Heck, sometimes price will just ignore Mr. Fibonacci and blow past all the levels just like how Lebron James bullies his way through the lane with sheer force.

Remember, the market will not always resume its uptrend after finding temporary support or resistance, but instead continue to go past the recent Swing High or Low.

Another common problem in using the Fibonacci tool is determining which Swing Low and Swing High to use.

People look at charts differently, look at different time frames, and have their own fundamental biases. It is likely that Stephen from Pipbuktu and the girl from Pipanema have different ideas of where the Swing High and Swing Low points should be.

The bottom line is that there is no absolute right way to do it, especially when the trend on the chart isn't so clear. Sometimes it becomes a guessing game.

That's why you need to hone your skills and combine the Fibonacci tool with other tools in your forex toolbox to help give you a higher probability of success.

In the next lesson, we'll show you how to use the Fibonacci tool in combination with other forms of support and resistance levels and candlesticks.

# Combining Fibs with Support and Resistance

Like we said in the previous section, using Fibonacci levels can be very subjective. However, there are ways that you can help tilt the odds in your favor.

While the Fibonacci tool is extremely useful, it shouldn't be used all by its lonesome self.

It's kinda like comparing it to NBA superstar Kobe Bryant. Kobe is one of the greatest basketball players of all time, but even he couldn't win those titles by himself. He needs some backup.

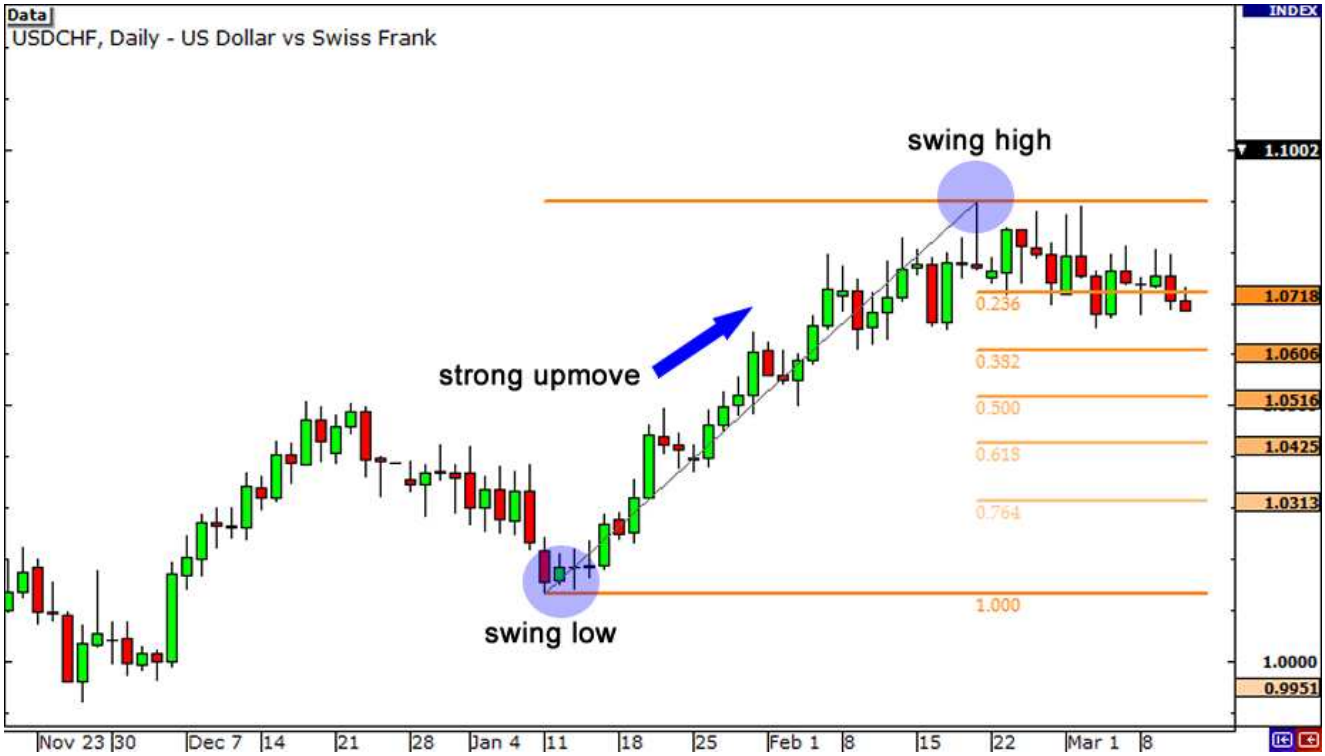
Similarly, the Fibonacci tool should be used in combination with other tools. In this section, let's take what you've learned so far and try to combine them to help us spot some sweet trade setups.

Are y'all ready? Let's get this pip show on the road!

One of the best ways to use the Fibonacci tool is to spot potential support and resistance levels and see if they line up with Fibonacci retracement levels.

If Fib levels are already support and resistance levels, and you combine them with other price areas that a lot of other traders are watching, then the chances of price bouncing from those areas are much higher.

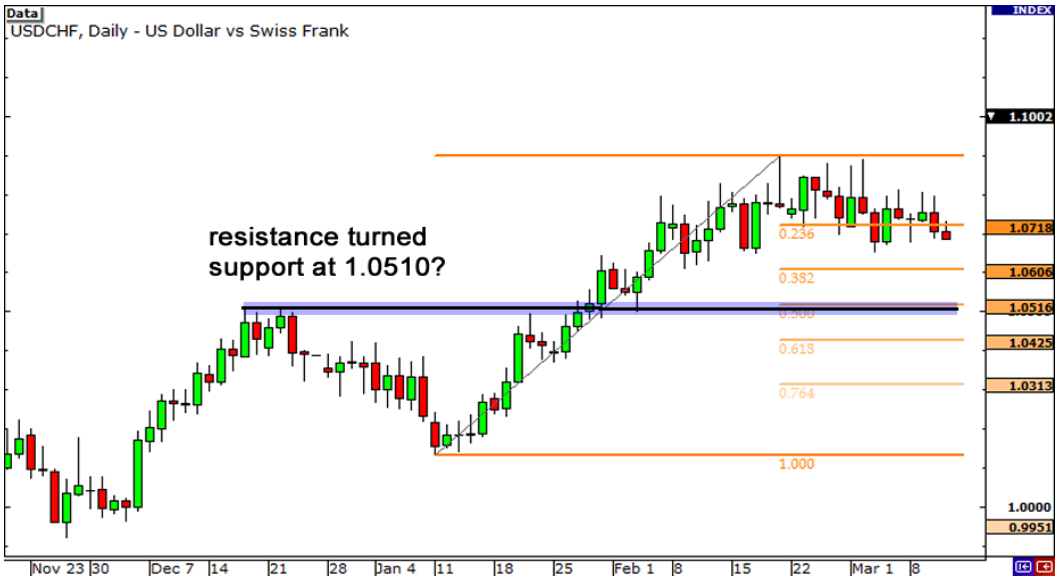
Let's look at an example of how you can combine support and resistance levels with Fib levels. Below is a daily chart of USD/CHF.




As you can see, it's been on an uptrend recently. Look at all those green candles! You decide that you want to get in on this long USD/CHF bandwagon.

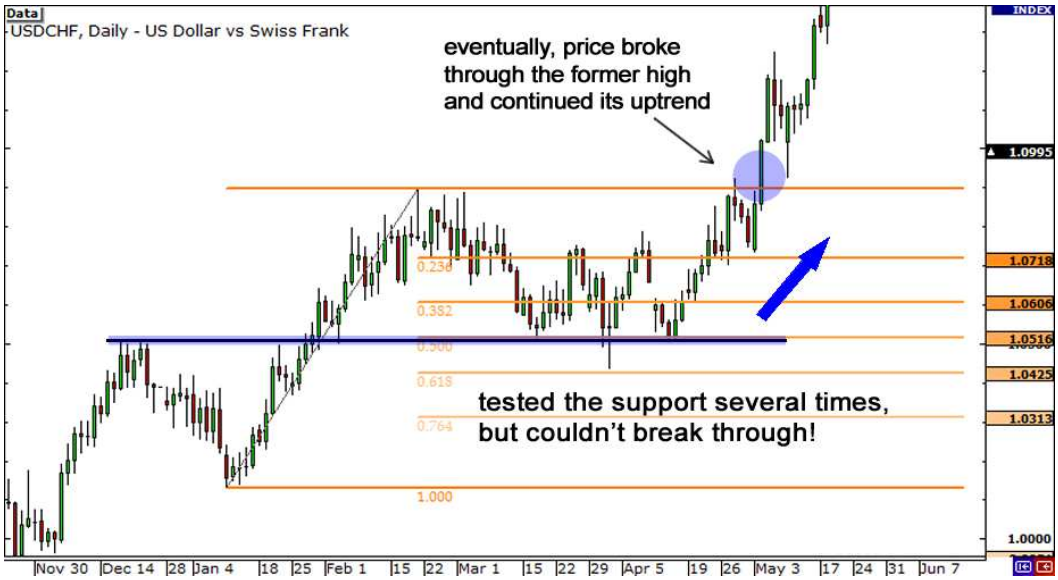
But the question is, "When do you enter?" You bust out the Fibonacci tool, using the low at 1.0132 on January 11 for the Swing Low and the high at 1.0899 on February 19 for the Swing High.

Now your chart looks pretty sweet with all those Fib levels.




Now that we have a framework to increase our probability of finding solid entry, we can answer the question "Where should you enter?"

You look back a little bit and you see that the 1.0510 price was good resistance level in the past and it just happens to line up with the 50.0% Fib retracement level. Now that it's broken, it could turn into support and be a good place to buy.




If you did set an order somewhere around the 50.0% Fib level, you'd be a pretty happy camper!

There would have been some pretty tense moments, especially on the second test of the support level on April 1. Price tried to pierce through the support level, but failed to close below it. Eventually, the pair broke past the Swing High and resumed its uptrend.

You can do the same setup on a downtrend as well. The point is you should look for price levels that seem to have been areas of interest in the past. If you think about it, there's a higher chance that price will bounce from these levels.

Why?

First, as we discussed in Grade 1, previous support or resistance levels would be good areas to buy or sell because other traders will also be eyeing these levels like a hawk.

Second, since we know that a lot of traders also use the Fibonacci tool, they may be looking to jump in on these Fib levels themselves.

With traders looking at the same support and resistance levels, there's a good chance that there are a ton of orders at those price levels.

While there's no guarantee that price will bounce from those levels, at least you can be more confident about your trade. After all, there is strength in numbers!

Remember that trading is all about probabilities. If you stick to those higher probability trades, then there's a better chance of coming out ahead in the long run.

# Combining Fibs with Trend Lines

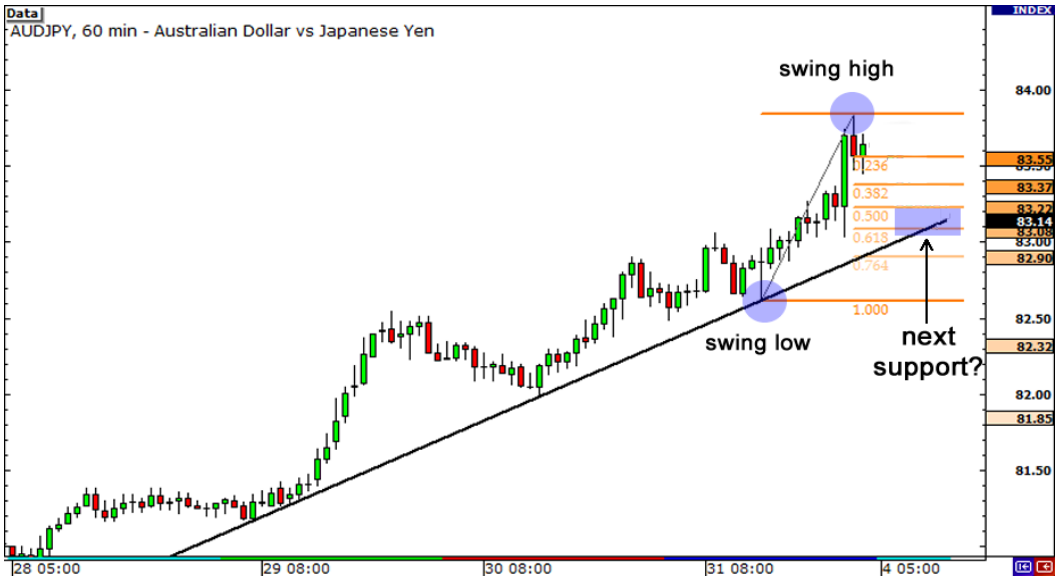
Another good tool to combine with the Fibonacci tool is trend line analysis. After all, Fibonacci levels work best when the market is trending, so this makes a lot of sense!

Remember that whenever a pair is in a downtrend or uptrend, traders use Fibonacci retracement levels as a way to get in on the trend. So why not look for levels where Fib levels line up right smack with the trend?

Here's a 1-hour chart of AUD/JPY. As you can see, price has been respecting a short term rising trend line over the past couple of days.

You think to yourself, "Hmm, that's a sweet uptrend right there. I wanna buy AUD/JPY, even if it's just for a short term trade. I think I'll buy once the pair hits the trend line again."

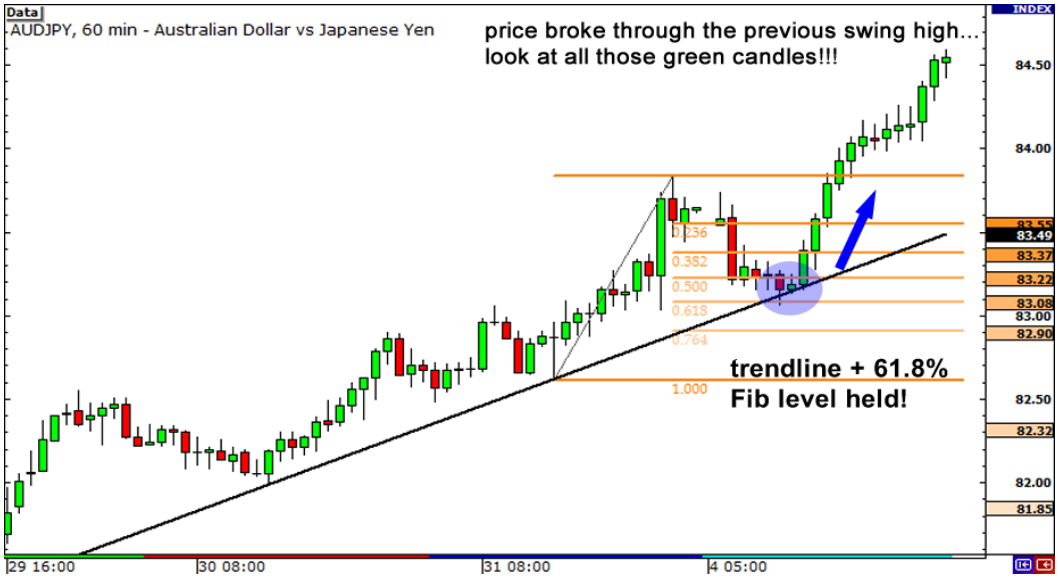
Before you do that though, why don't you reach for your forex tool box and get that Fibonacci tool out? Let's see if we can get a more exact entry price.




Here we plotted the Fibonacci retracement levels by using the Swing low at 82.61 and the Swing High at 83.84.

Notice how the 50.0% and 61.8% Fib levels are intersected by the rising trend line.

Could these levels serve as potential support levels? There's only one way to find out!




Guess what? The 61.8% Fib level held, as price bounced there before heading back up. If you had set some orders at that level, you would have had a perfect entry!

A couple of hours after touching the trend line, price zoomed up like Astroboy on Red Bull, bursting through the Swing High.

Aren't you glad you've got this in your forex toolbox now?

As you can see, it does pay to make use of the Fibonacci tool, even if you're planning to enter on a retest of the trend line. The combination of both a diagonal and a horizontal support or resistance level could mean that other traders are eying those levels as well.

Take note though, as with other drawing tools, drawing trend lines can also get pretty subjective.

You don't know exactly how other traders are drawing them, but you can count on one thing - that there's a trend!

If you see that a trend is developing, you should be looking for ways to go long to give you a better chance of a profitable trade. You can use the Fibonacci tool to help you find potential entry points.

# Combining Fibs with Candlesticks

If you've been paying attention in class, you'd know by now that you can combine the Fibonacci tool with support and resistance levels and trend lines to create a simple but super awesome trading strategy.

But we ain't done yet! In this lesson, we're going to teach you how to combine the Fibonacci tool with your knowledge of Japanese candlestick patterns that you learned in Grade 2.

In combining the Fibonacci tool with candlestick patterns, we are actually looking for exhaustive candlesticks. If you can tell when buying or selling pressure is exhausted, it can give you a clue of when price may continue trending.

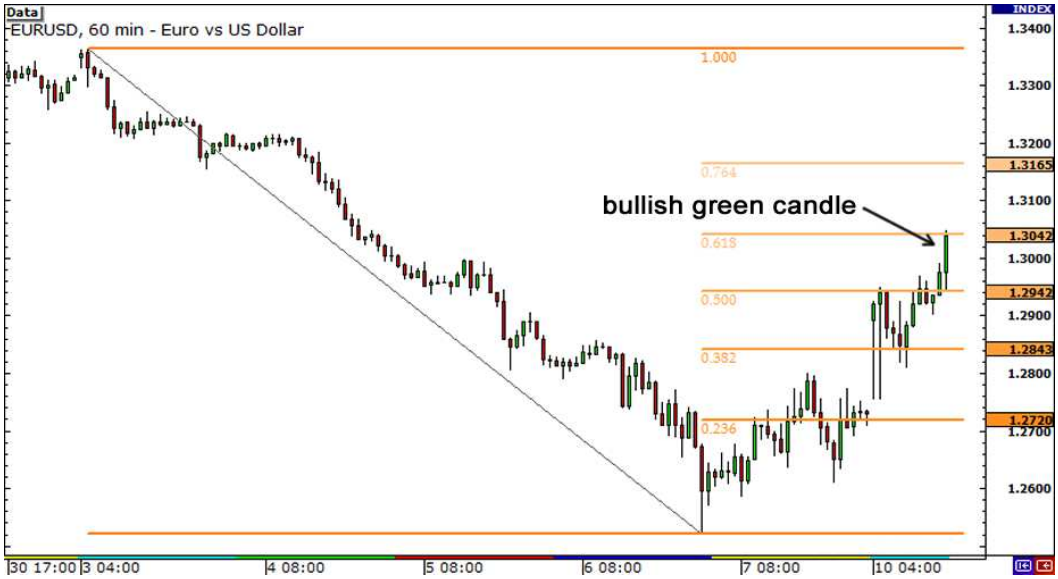
We here at BabyPips.com like to call them "Fibonacci Candlesticks," or "Fib Sticks" for short. Pretty catchy, eh? Let's take a look at an example to make this clearer.

Below is a 1-hour chart of EUR/USD.

The pair seems to have been in a downtrend the past week, but the move seems to have paused for a bit. Will there be a chance to get in on this downtrend? You know what this means. It's time to take the Fibonacci tool and get to work!

As you can see from the chart, we've set our Swing High at 1.3364 on March 3, with the Swing Low at 1.2523 on March 6.

Since it's a Friday, you decided to just chill out, take an early day off, and decide when you wanna enter once you see the charts after the weekend.




Whoa! By the time you popped open your charts, you see that EUR/USD has shot up quite a bit from its Friday closing price.

While the 50.0% Fib level held for a bit, buyers eventually took the pair higher. You decide to wait and see whether the 61.8% Fib level holds. After all, the last candle was pretty bullish! Who knows, price just might keep shooting up!

Well, will you look at that? A long legged doji has formed right smack on the 61.8% Fib level. If you paid attention in Grade 2, you'd know that this is an "exhaustive candle." Has buying pressure died down? Is resistance at the Fib level holding? It's possible. Other traders were probably eyeing that Fib level as well.

Is it time to short? You can never know for sure (which is why risk management is so important), but the probability of a reversal looks pretty darn good!

If you had shorted right after that doji had formed, you could have made some serious profits. Right after the doji, price stalled for a bit before heading straight down. Take a look at all those red candles!

It seems that buyers were indeed pretty tired, which allowed sellers to jump back in and take control. Eventually, price went all the way back down to the Swing Low. That was a move of about 500 pips! That could've been your trade of the year! >

Looking for "Fib Sticks" can be really useful, as they can signal whether a Fib level will hold.

If it seems that price is stalling on a Fib level, chances are that other traders may have put some orders at those levels. This would act as more confirmation that there is indeed some resistance or support at that price.

Another nice thing about Fib Sticks is that you don't need to place limit orders at the Fib levels. You may have some concerns whether the support or resistance will hold since we are looking at a "zone" and not necessarily specific levels.

This is where you can use your knowledge of candlestick formations.

You could wait for a Fib Stick to form right below or above a Fib level to give you more confirmation on whether you should put in an order.

If a Fib stick does form, you can just enter a trade at market price since you now have more confirmation that level could be holding.

# Fibonacci Extensions

The next use of Fibonacci will be using them to find targets.

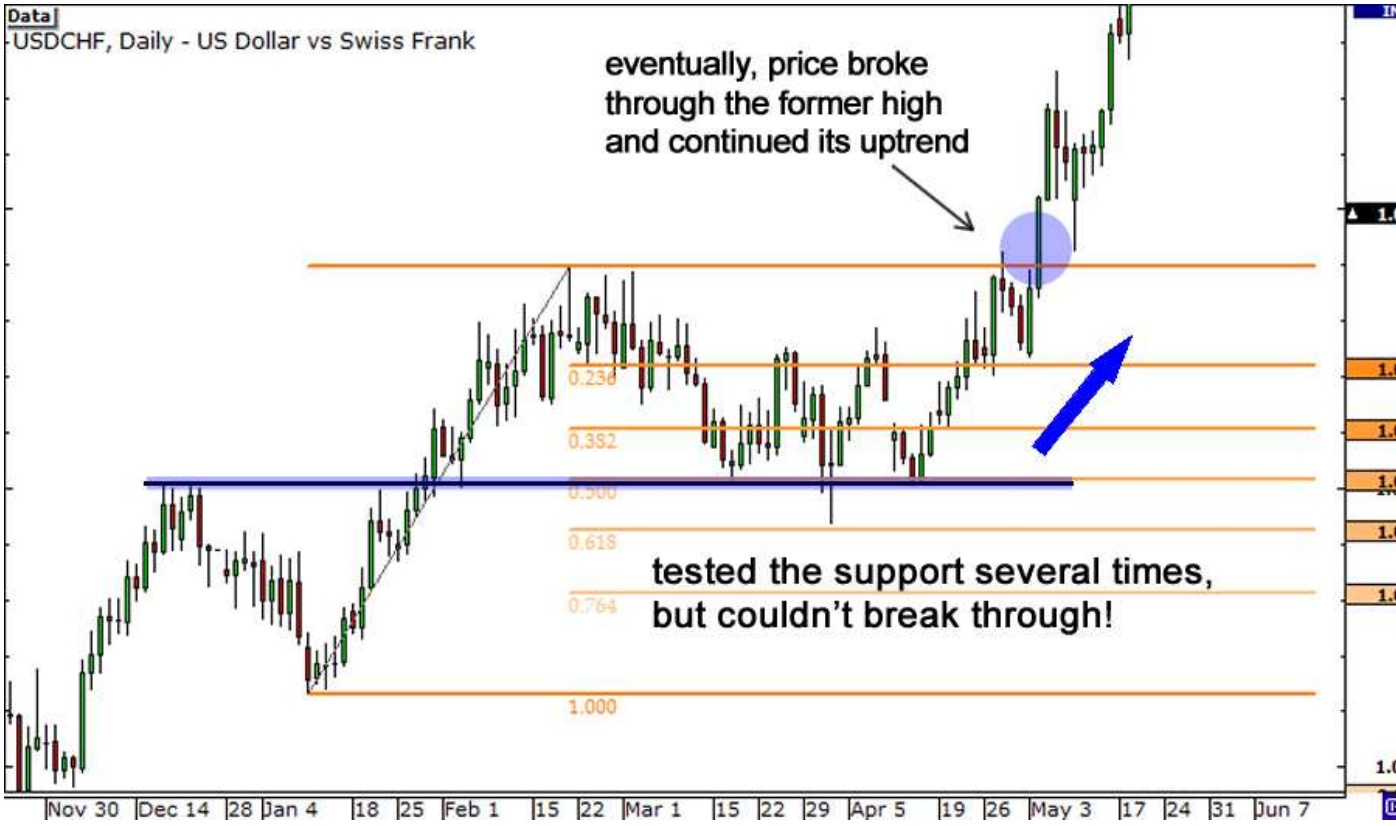
Gotta always keep in mind "Zombieland Rules of Survival #22" - When in doubt, know your way out! Let's start with an example in an uptrend.

In an uptrend, the general idea is to take profits on a long trade at a Fibonacci Price Extension Level. You determine the Fibonacci extension levels by using three mouse clicks.

First, click on a significant Swing Low, then drag your cursor and click on the most recent Swing High. Finally, drag your cursor back down and click on any of the retracement levels.

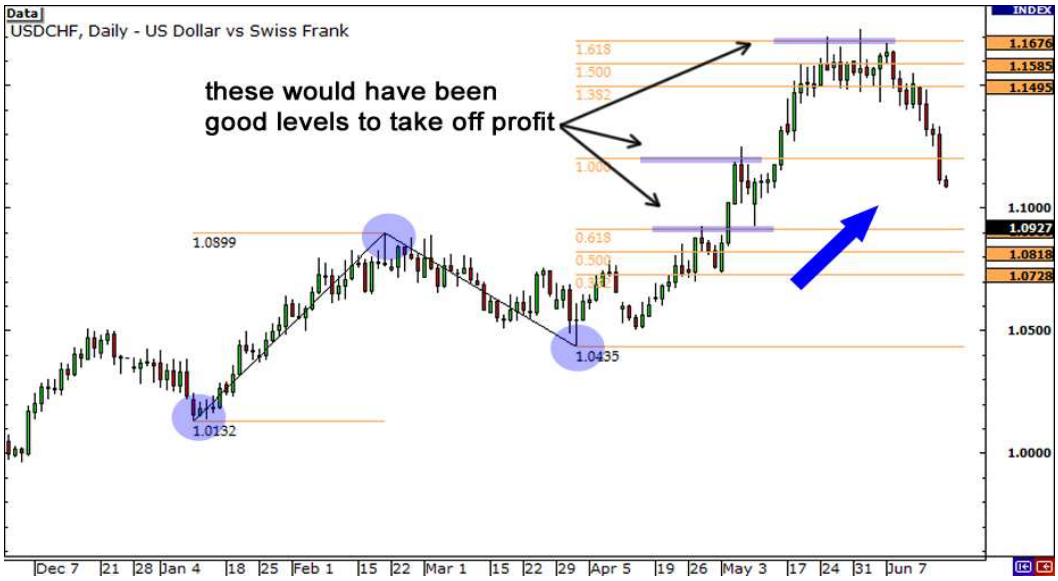
This will display each of the Price Extension Levels showing both the ratio and corresponding price levels. Pretty neat, huh?

Let's go back to that example with the USD/CHF chart we showed you in the previous lesson.




The 50.0% Fib level held strongly as support and, after three tests, the pair finally resumed its uptrend. In the chart above, you can even see price rise above the previous Swing High.

Let's pop on the Fibonacci extension tool to see where would have been a good place to take off some profits.




Here's a recap of what happened after the retracement Swing Low occurred:

- Price rallied all the way to the 61.8% level, which lined up closely with the previous Swing High.
- It fell back to the 38.2% level, where it found support
- Price then rallied and found resistance at the 100% level.
- A couple of days later, price rallied yet again before finding resistance at the 161.8% level.

As you can see from the example, the 61.8%, 100% and 161.8% levels all would have been good places to take off some profits.

Now, let's take a look at an example of using Fibonacci extension levels in a downtrend.

In a downtrend, the general idea is to take profits on a short trade at a Fibonacci extension level since the market often finds support at these levels.

Let's take another look at that downtrend on the 1-hour EUR/USD chart we showed you in the Fib Sticks lesson.

Here, we saw a doji form just under the 61.8% Fib level. Price then reversed as sellers jumped back in, and brought price all the way back down to the Swing Low.

Let's put up that Fib Extension tool to see where would have been some good places to take profits had we shorted at the 61.8% retracement level.

Here's what happened after price reversed from the Fibonacci retracement level:

- Price found support at the 38.2% level
- The 50.0% level held as initial support, then became an area of interest
- The 61.8% level also became an area of interest, before price shot down to test the previous Swing Low
- If you look ahead, you'll find out that the 100% extension level also acted as support

We could have taken off profits at the 38.2%, 50.0%, or 61.8% levels. All these levels acted as support, possibly because other traders were keeping an eye out for these levels for profit taking as well.

The examples illustrate that price finds at least some temporary support or resistance at the Fibonacci extension levels - not always, but often enough to correctly adjust your position to take profits and manage your risk.

Of course, there are some problems to deal with here.

First, there is no way to know which exact Fibonacci extension level will provide resistance. Any of these levels may or may not act as support or resistance.

Another problem is determining which Swing Low to start from in creating the Fibonacci extension levels.

One way is from the last Swing Low as we did in the examples; another is from the lowest Swing Low of the past 30 bars. Again, the point is that there is no one right way to do it, but with a lot of practice, you'll make better decisions of picking Swing points.

You will have to use your discretion in using the Fibonacci extension tool. You will have to judge how much longer the trend will continue. Later on, we will teach you methods to help you determine the strength of a trend.

For now, let's move on to stop loss placement!

# Placing Stops with Fibs

Probably just as important as knowing where to enter or take off profits is knowing where to place your stop loss.

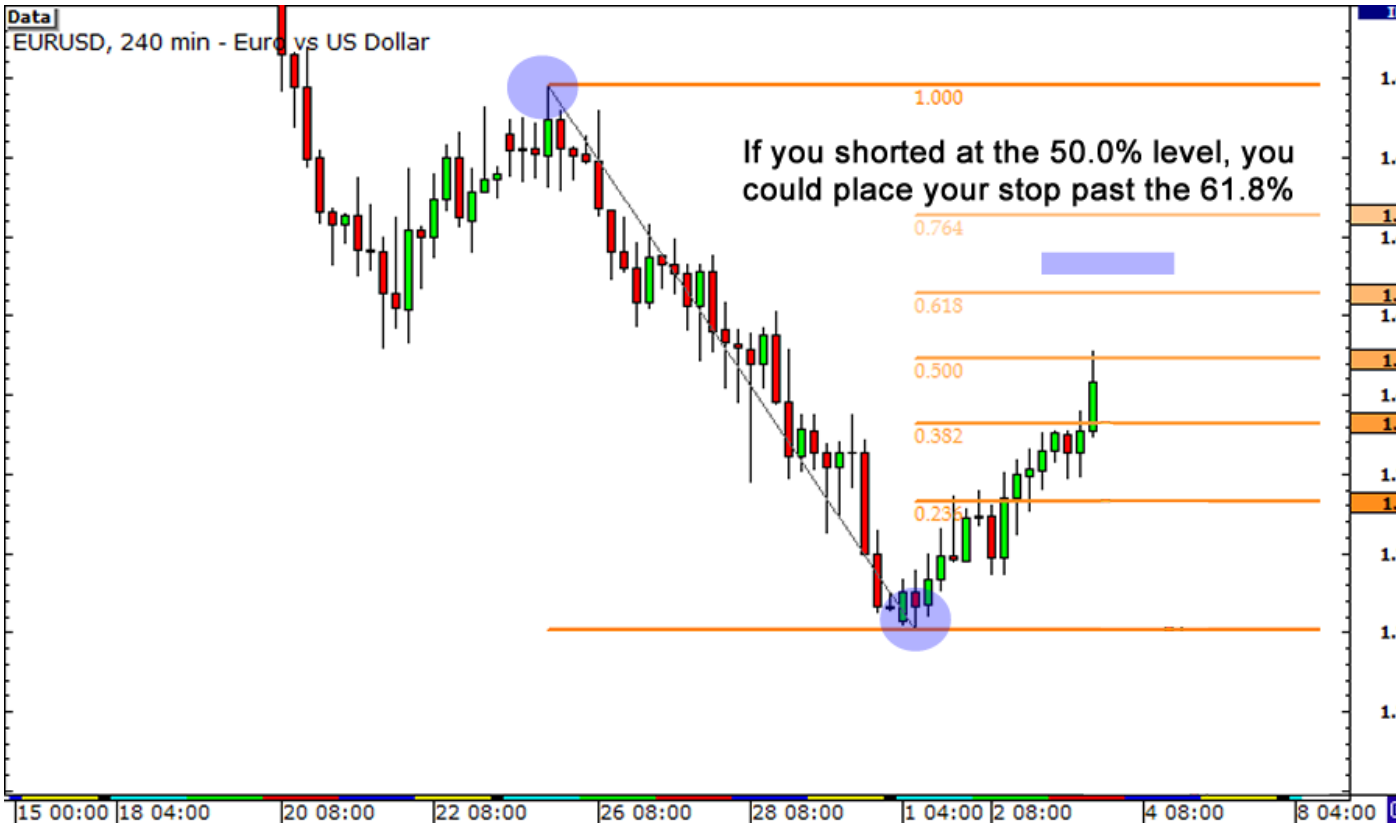
You can't just enter a trade based on Fib levels without having a clue where to exit. Your account will just go up in flames and you will forever blame Fibonacci, cursing his name in Italian.

In this lesson, you'll learn a couple of techniques to set your stops when you decide to use them trusty Fib levels. These are simple ways to set your stop and the rationale behind each method.

The first method is to set your stop just past the next Fibonacci level.

If you were planning to enter at the 38.2% Fib level, then you would place your stop beyond the 50.0% level. If you felt like the 50.0% level would hold, then you'd put your stop past the 61.8% level and so on and so forth. Simple, right?

Let's take another look at that 4-hour EUR/USD chart we showed you back in the Fibonacci retracement lesson.




If you had shorted at the 50.0%, you could have placed your stop loss order just past the 61.8% Fib level.

The reasoning behind this method of setting stops is that you believed that the 50.0% level would hold as a resistance point. Therefore, if price were to rise beyond this point, your trade idea would be invalidated.

The problem with this method of setting stops is that it is entirely dependent on you having a perfect entry.

Setting a stop just past the next Fibonacci retracement level assumes that you are really confident that the support or resistance area will hold. And, as we pointed out earlier, using drawing tools isn't an exact science.

The market might shoot up, hit your stop, and eventually go in your direction. This is usually when we'd go to a corner, and start hitting our head on the wall.

We're just warning you that this might happen, sometimes a few times in a row, so make sure you limit your losses quickly and let your winners run with the trend. It might be best if you used this type of stop placement method for short term, intraday trades.

Now, if you want to be a little safer, another way to set your stops would be to place them past the recent Swing High or Swing Low.

This type of stop loss placement would give your trade more room to breathe and give you a better chance for the market to move in favor of your trade.

If the market price were to surpass the Swing High or Swing Low, it may indicate that a reversal of the trend is already in place. This means that your trade idea or setup is already invalidated and that you're too late to jump in.

Setting larger stop losses would probably be best used for longer term, swing-type trades, and you can also incorporate this into a "scaling in" method, which you will learn later on in this course.

Of course, with a larger stop, you also have to remember to adjust your position size accordingly.

If you tend to trade the same position size, you may incur large losses, especially if you enter at one of the earlier Fib levels.

This can also lead to some unfavorable reward-to-risk ratios, as you may have a wide stop that isn't proportional to your potential reward.

### *So which way is better?*

The truth is, just like in combining the Fibonacci retracement tool with support and resistance, trend lines, and candlesticks to find a better entry, it would be best to use your knowledge of these tools to analyze the current environment to help you pick a good stop loss point.

As much as possible, you shouldn't rely solely on Fib levels as support and resistance points as the basis for stop loss placement.

Remember, stop loss placement isn't a sure thing, but if you can tilt the odds in your favor by combining multiple tools, it could help give you a better exit point, more room for your trade to breathe, and possibly a better reward-to-risk ratio trade.

# Summary: Fibonacci

The key Fibonacci retracement levels to keep an eye on are the 23.6%, 38.2%, 50.0%, 61.8%, and 76.4%. The ones that seem to hold the most weight are the 38.2%, 50.0%, and 61.8% levels. These are normally included in the default settings of any Fibonacci retracement software.

If your trading software doesn't have a Fib tool, no worries - we've got a Fibonacci calculator that will do all the work for you!

Traders use the Fibonacci retracement levels as potential **support and resistance**. Since plenty of traders watch these same levels and place buy and sell orders on them to enter trades or place stops, the support and resistance levels may become a self-fulfilling prophecy.

They key Fibonacci extension levels are the 38.2%, 50.0%, 61.8%, 100%, 138.2% and 161.8%.

Traders use the Fibonacci extension levels as potential support and resistance areas to set profit targets. Again, since so many traders are watching these levels and placing buy and sell orders to take profits, this tool tends to work due self-fulfilling expectations.
In order to apply Fibonacci levels to your charts, you'll need to identify Swing High and Swing Low points.

A Swing High is a candlestick with at least two lower highs on both the left and right of itself.

A Swing Low is a candlestick with at least two higher lows on both the left and right of itself.

Because many traders use the Fibonacci tool, those levels tend to become self-fulfilling support and resistance levels or areas of interest.

When using the Fibonacci tool, probability of success could increase when using the Fib tool with other support and resistance levels, trend lines, and candlestick patterns for spotting entry and stop loss points.

# Silky Smooth Moving Averages

A moving average is simply a way to smooth out price action over time. By "moving average", we mean that you are taking the average closing price of a currency pair for the last 'X' number of periods. On a chart, it would look like this:

Like every indicator, a moving average indicator is used to help us forecast future prices. By looking at the slope of the moving average, you can better determine the potential direction of market prices.

As we said, moving averages smooth out price action.

There are different types of moving averages and each of them has their own level of "smoothness".

Generally, the smoother the moving average, the slower it is to react to the price movement.

The choppier the moving average, the quicker it is to react to the price movement. To make a moving average smoother, you should get the average closing prices over a longer time period.
Now, you're probably thinking, "C'mon, let's get to the good stuff. How can I use this to trade?"

In this section, we first need to explain to you the two major types of moving averages:

1. Simple
2. Exponential

We'll also teach you how to calculate them and give the pros and cons of each. Just like in every other lesson in the BabyPips.com School of Pipsology, you need to know the basics first!

After you've got that on lockdown like Argentinian soccer player Lionel Messi's ball-handling skills, we'll teach you the different ways to use moving averages and how to incorporate them into your trading strategy.

By the end of this lesson, you'll be just as smooth as Messi's!

Are you ready?

If you are, give us a "Heck yeah!"

If not, go back and reread the intro.

Once you're pumped and ready to go, head to the next page.

# Simple Moving Averages

A simple moving average is the simplest type of moving average (DUH!). Basically, a simple moving average is calculated by adding up the last "X" period's closing prices and then dividing that number by X.

Confused???

Don't worry, we'll make it crystal clear.

If you plotted a 5 period simple moving average on a 1-hour chart, you would add up the closing prices for the last 5 hours, and then divide that number by 5. Voila! You have the average closing price over the last five hours! String those average prices together and you get a moving average!

If you were to plot a 5-period simple moving average on a 10-minute chart, you would add up the closing prices of the last 50 minutes and then divide that number by 5.

If you were to plot a 5 period simple moving average on a 30 minute chart, you would add up the closing prices of the last 150 minutes and then divide that number by 5.

If you were to plot the 5 period simple moving average on the 4 hr. chart... Okay, okay, we know, we know. You get the picture!

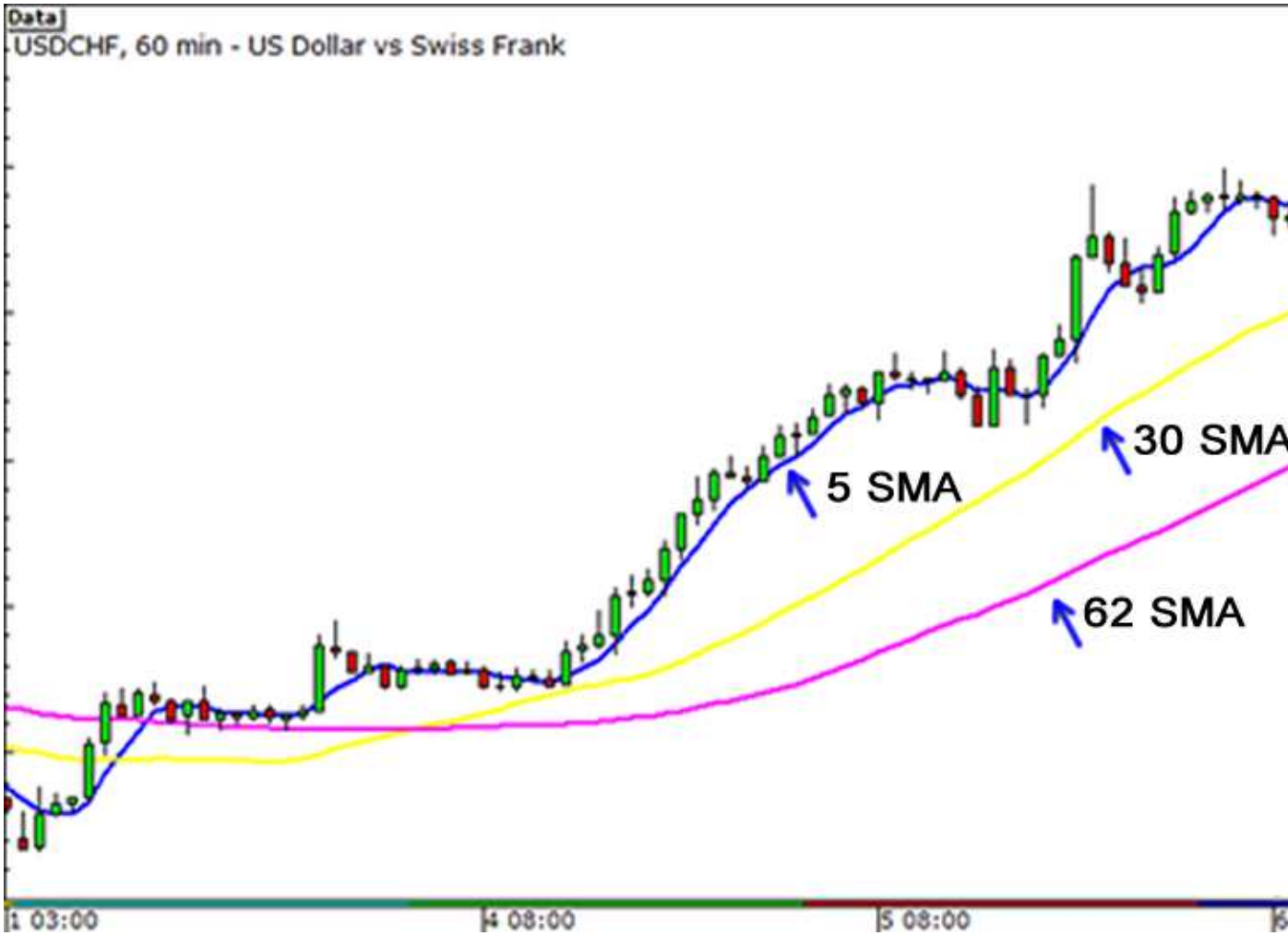
Most charting packages will do all the calculations for you. The reason we just bored you (yawn!) with a "how to" on calculating simple moving averages is because it's important to understand so that you know how to edit and tweak the indicator.

Understanding how an indicator works means you can adjust and create different strategies as the market environment changes.

Now, just like almost any other indicator out there, moving averages operate with a delay. Because you are taking the averages of past price history, you are really only seeing the general path of the recent past and the general direction of "future" short term price action.

**Disclaimer: Moving averages will not turn you into Ms. Cleo the psychic!**

Here is an example of how moving averages smooth out the price action.




On chart above, we've plotted three different SMAs on the 1-hour chart of USD/CHF. As you can see, the longer the SMA period is, the more it lags behind the price.

Notice how the 62 SMA is farther away from the current price than the 30 and 5 SMAs.

This is because the 62 SMA adds up the closing prices of the last 62 periods and divides it by 62. The longer period you use for the SMA, the slower it is to react to the price movement.

The SMAs in this chart show you the overall sentiment of the market at this point in time. Here, we can see that the pair is trending.

Instead of just looking at the current price of the market, the moving averages give us a broader view, and we can now gauge the general direction of its future price. With the use of SMAs, we can tell whether a pair is trending up, trending down, or just ranging.

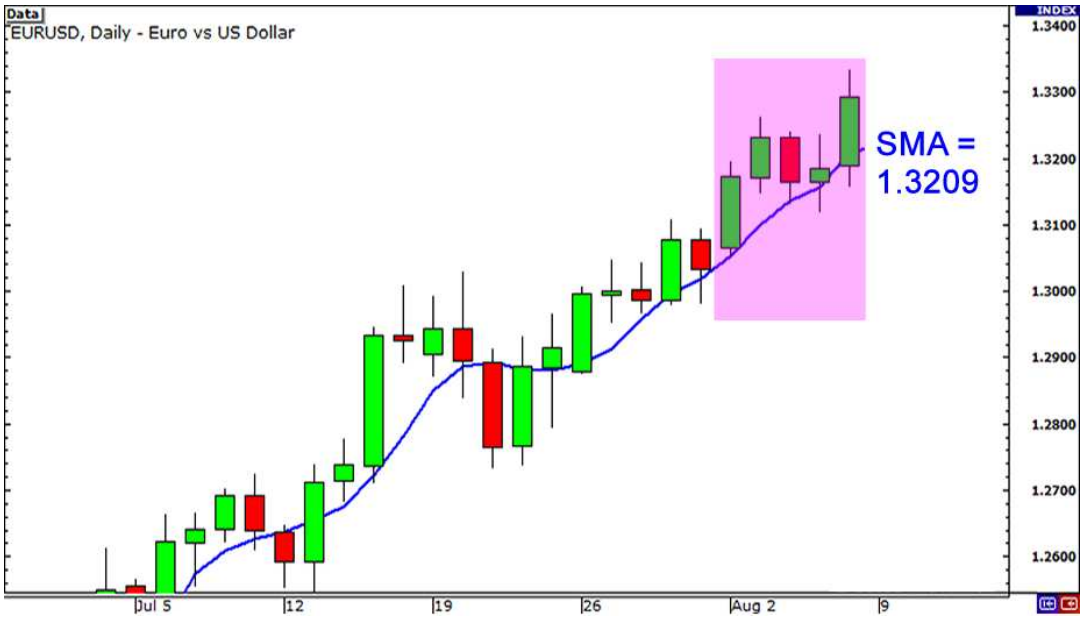
There is one problem with the simple moving average and it's that they are susceptible to spikes. When this happens, this can give us false signals. We might think that a new trend may be developing but in reality, nothing changed.

In the next lesson, we will show you what we mean, and also introduce you to another type of moving average to avoid this problem.

# Exponential Moving Average

As we said in the previous lesson, simple moving averages can be distorted by spikes. We'll start with an example.

Let's say we plot a 5-period SMA on the daily chart of EUR/USD.




The closing prices for the last 5 days are as follows:

Day 1: 1.3172
Day 2: 1.3231
Day 3: 1.3164
Day 4: 1.3186
Day 5: 1.3293

The simple moving average would be calculated as follows:

(1.3172 + 1.3231 + 1.3164 + 1.3186 + 1.3293) / 5 = 1.3209

Simple enough, right?

Well what if there was a news report on Day 2 that causes the euro to drop across the board. This causes EUR/USD to plunge and close at 1.3000. Let's see what effect this would have on the 5 period SMA.

Day 1: 1.3172
Day 2: **1.3000**
Day 3: 1.3164
Day 4: 1.3186
Day 5: 1.3293

The simple moving average would be calculated as follows:

(1.3172 + **1.3000** + 1.3164 + 1.3186 + 1.3293) / 5 = **1.3163**

The result of the simple moving average would be a lot lower and it would give you the notion that the price was actually going down, when in reality, Day 2 was just a one-time event caused by the poor results of an economic report.

The point we're trying to make is that sometimes the simple moving average might be too simple. If only there was a way that you could filter out these spikes so that you wouldn't get the wrong idea. Hmm... Wait a minute... Yep, there is a way!

It's called the **Exponential Moving Average**!

Exponential moving averages (EMA) give more weight to the most recent periods. In our example above, the EMA would put more weight on the prices of the most recent days, which would be Days 3, 4, and 5.

This would mean that the spike on Day 2 would be of lesser value and wouldn't have as big an effect on the moving average as it would if we had calculated for a simple moving average.

If you think about it, this makes a lot of sense because what this does is it puts more emphasis on what traders are doing recently.

Let's take a look at the 4-hour chart of USD/JPY to highlight how an SMA and EMA would look side by side on a chart.

Notice how the red line (the 30 EMA) seems to be closer price than the blue line (the 30 SMA). This means that it more accurately represents recent price action. You can probably guess why this happens.

It's because the EMA places more emphasis on what has been happening lately. When trading, it is far more important to see what traders are doing NOW rather what they were doing last week or last month.

# SMA vs. EMA

By now, you're probably asking yourself, which is better? The simple or the exponential moving average?

First, let's start with the exponential moving average. When you want a moving average that will respond to the price action rather quickly, then a short period EMA is the best way to go.

These can help you catch trends very early (more on this later), which will result in higher profit. In fact, the earlier you catch a trend, the longer you can ride it and rake in those profits (boo yeah!).

The downside to using the exponential moving average is that you might get faked out during consolidation periods (oh no!).

Because the moving average responds so quickly to the price, you might think a trend is forming when it could just be a price spike. This would be a case of the indicator being too fast for your own good.

With a simple moving average, the opposite is true. When you want a moving average that is smoother and slower to respond to price action, then a longer period SMA is the best way to go.

This would work well when looking at longer time frames, as it could give you an idea of the overall trend.

Although it is slow to respond to the price action, it could possibly save you from many fake outs. The downside is that it might delay you too long, and you might miss out on a good entry price or the trade altogether.

An easy analogy to remember the difference between the two is to think of a hare and a toirtoise.

The tortoise is slow, like the SMA, so you might miss out on getting in on the trend early. However, it has a hard shell to protect itself, and similarly, using SMAs would help you avoid getting caught up in fakeouts.

On the other hand, the hare is quick, like the EMA. It helps you catch the beginning of the trend but you run the risk of getting sidetracked by fakeouts (or naps if you're a sleepy trader).

Below is a table to help you remember the pros and cons of each.

| | SMA | EMA |
|---|---|---|
| **Pros** | Displays a smooth chart which eliminates most fakeouts. | Quick Moving and is good at showing recent price swings. |
| **Cons** | Slow moving, which may cause a a lag in buying and selling signals | More prone to cause fakeouts and give errant signals. |

So which one is better?

It's really up to you to decide.

Many traders plot several different moving averages to give them both sides of the story. They might use a longer period simple moving average to find out what the overall trend is, and then use a shorter period exponential moving average to find a good time to enter a trade.

There are a number of trading strategies that are built around the use of moving averages. In the following lessons, we will teach you:

1. How to use moving averages to determine the trend
2. How to incorporate the crossover of moving averages into your trading system
3. How moving averages can be used as dynamic support and resistance

Time for recess! Go find a chart and start playing with some moving averages! Try out different types and try experimenting with different periods. In time, you will find out which moving averages work best for you.

# Using Moving Averages

One sweet way to use moving averages is to help you determine the trend.

The simplest way is to just plot a single moving average on the chart. When price action tends to stay above the moving average, it would signal that price is in a general uptrend.

If price action tends to stay below the moving average, then it would indicate that it is in a downtrend.

The problem with this is that it's too simplistic.

Let's say that USD/JPY has been in a downtrend, but a news report comes out causing it surge higher.

You see that the price is now above the moving average. You think to yourself:

"Hmmm... It looks like this pair is about to shift direction. Time to buy this sucker!"

So you do just that. You buy a billion units cause you're confident that USD/JPY is going to rise.

Bammm! You got faked out! As it turns out, traders just reacted to the news but the trend continued and price kept heading lower!

What some traders do - and what we suggest you do as well - is that they plot a couple of moving averages on their charts instead of just one. This gives them a clearer signal of whether the pair is trending up or down depending on the order of the moving averages. Let us explain.

In an uptrend, the "faster" moving average should be above the "slower" moving average and for a downtrend, vice versa. For example, let's say we have two MAs: the 10-period MA and the 20-period MA. On your chart, it would look like this:

Above is a daily chart of USD/JPY. Throughout the uptrend, the 10 SMA is above the 20 SMA. As you can see, you can use moving averages to help show whether a pair is trending up or down. Combining this with your knowledge on trend lines, this can help you decide whether to go long or short a currency.

You can also try putting more than two moving averages on your chart. Just as long as lines are in order (fastest to slowest in an uptrend, slowest to fastest in an downtrend), then you can tell whether the pair is in an uptrend or in a downtrend.

# Moving Average Crossover Trading

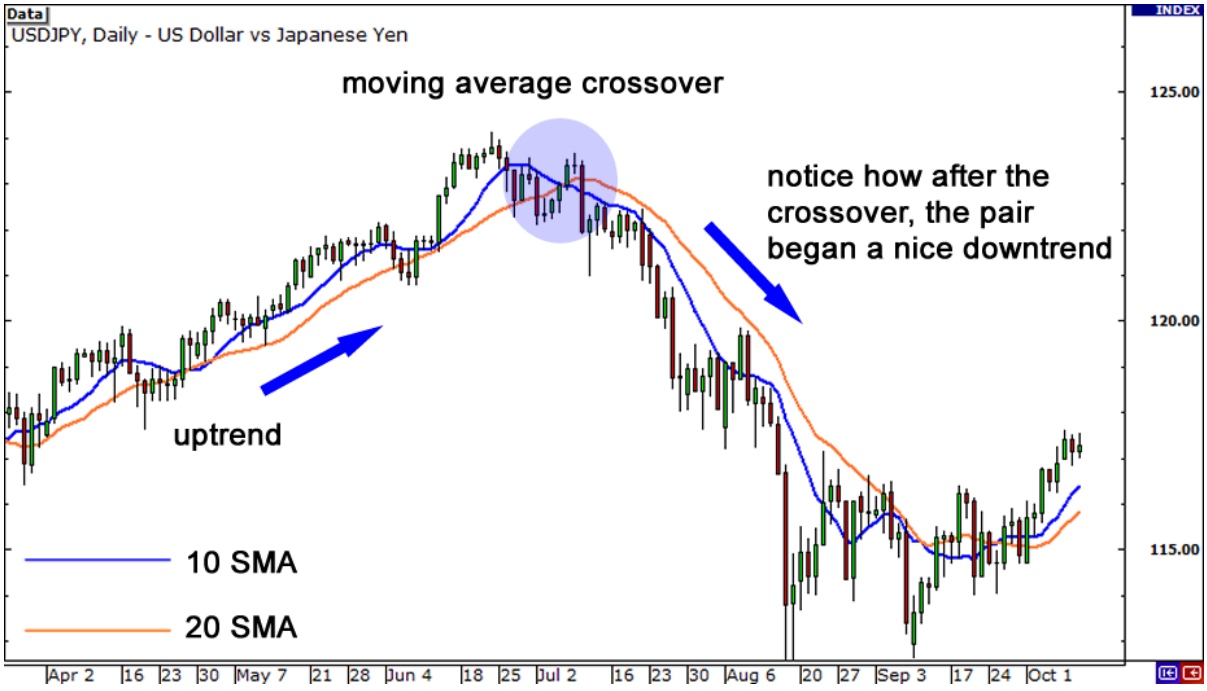
By now, you know how to determine the trend by plotting on some moving averages on your charts. You should also know that moving averages can help you determine when a trend is about to end and reverse.

All you have to do is plop on a couple of moving averages on your chart, and wait for a crossover. If the moving averages cross over one another, it could signal that the trend is

about to change soon, thereby giving you the chance to get a better entry. By having a better entry, you have the chance to bag mo' pips!

If Allen Iverson made a living by having a killer crossover move, why can't you?

Let's take another look at that daily chart of USD/JPY to help explain moving average crossover trading.




From around April to July, the pair was in a nice uptrend. It topped out at around 124.00, before slowly heading down. In the middle of July, we see that the 10 SMA crossed below the 20 SMA.

And what happened next?

A nice downtrend!

If you had shorted at the crossover of the moving averages you would have made yourself almost a thousand pips!
Of course, not every trade will be a thousand-pip winner, a hundred-pip winner, or even a 10-pip winner.

It could be a loser, which means you have to consider things like where to place your stop loss or when to take profits. You just can't jump in without a plan!

What some traders do is that they close out their position once a new crossover has been made or once price has moved against the position a predetermined amount of pips.

This is what Huck does in her HLHB system. She either exits when a new crossover has been made, but also has a 150-pip stop loss just in case.

The reason for this is you just don't know when the next crossover will be. You may end up hurting yourself if you wait too long!

One thing to take note of with a crossover system is that while they work beautifully in a volatile and/or trending environment, they don't work so well when price is ranging.

You will get hit with tons of crossover signals and you could find yourself getting stopped out multiple times before you catch a trend again.

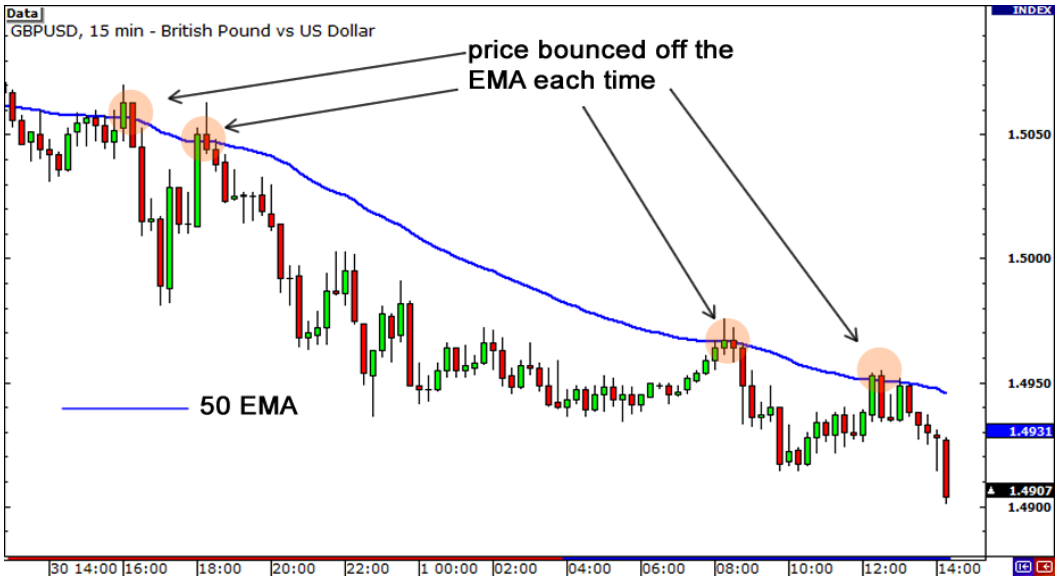
# Dynamic Support and Resistance

Another way to use moving averages is to use them as dynamic support and resistance levels.

We like to call it dynamic because it's not like your traditional horizontal support and resistance lines. They are constantly changing depending on recent price action.

There are many traders out there who look at these moving averages as key support or resistance. These traders will buy when price dips and tests the moving average or sell if price rises and touches the moving average.

Here's a look at the 15-minute chart of GBP/USD and pop on the 50 EMA. Let's see if it serves as dynamic support or resistance.




It looks like it held really well! Every time price approached 50 EMA and tested it, it acted as resistance and price bounced back down. Amazing, huh?

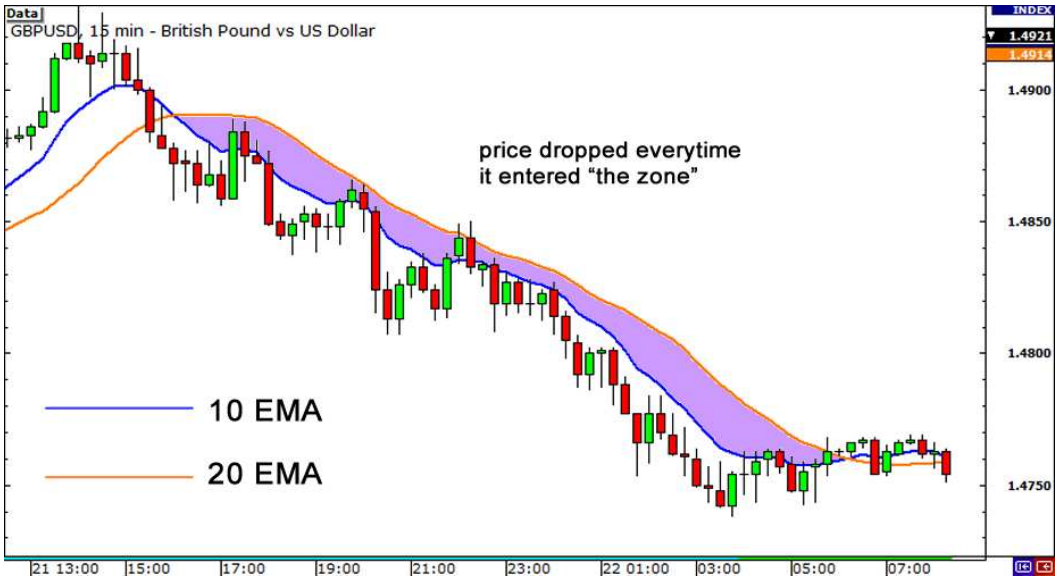
One thing you should keep in mind is that these are just like your normal support and resistance lines.

This means that price won't always bounce perfectly from the moving average. Sometimes it will go past it a little bit before heading back in the direction of the trend.

There are also times when price will blast past it altogether. What some traders do is that they pop on two moving averages, and only buy or sell once price is in the middle of the space between the two moving averages.

You could call this area "the zone".

Let's take another look at that 15-minute chart of GBP/USD, but this time let's use the 10 and 20 EMAs.




From the chart above, you see that price went slightly past the 10 EMA a few pips, but proceeded to drop afterwards.

There are some traders who use intraday strategies just like this. The idea is that just like your horizontal support and resistance areas, these moving averages should be treated like zones or areas of interest.

The area between moving averages could therefore be looked upon as a zone of support or resistance.

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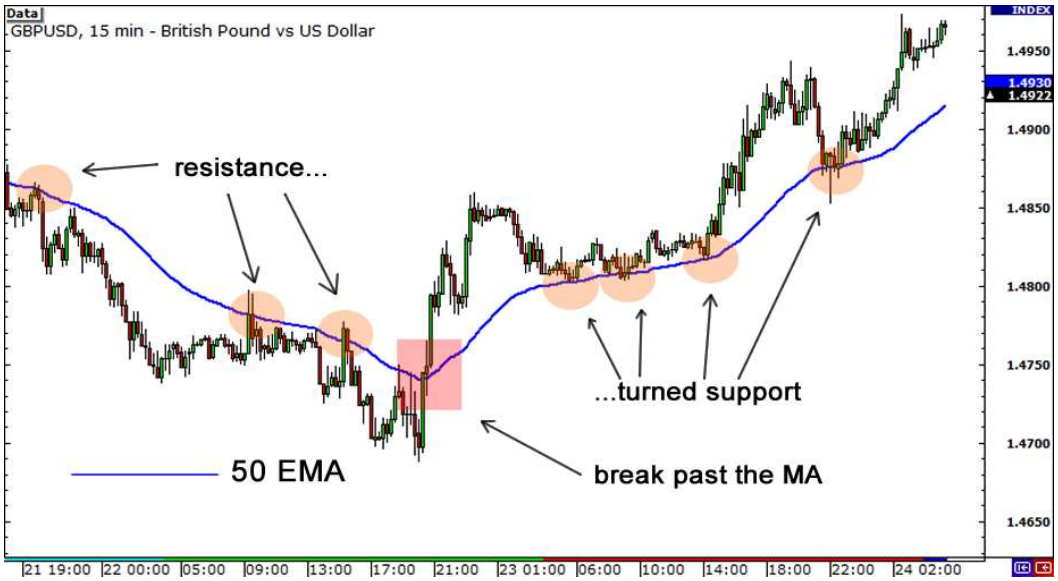
## *Breaking through Dynamic Support and Resistance*

Now you know that moving averages can potentially act as support and resistance. Combining a couple of them, you can have yourself a nice little zone. But you should also know that they can break, just like any support and resistance level!

Let's take another look at the 50 EMA on GBP/USD's 15-min chart.




In the chart above, we see that the 50 EMA held as a strong resistance level for a while as GBP/USD repeatedly bounced off it.

However, as we've highlighted with the red box, price finally broke through and shot up. Price then retraced and tested the 50 EMA again, which proved to be a strong support level.

So there you have it folks!

Moving averages can also act as dynamic support and resistance levels.

One nice thing about using moving averages is that they're always changing, which means that you can just leave it on your chart and don't have to keep looking back in time to spot potential support and resistance levels.

You know that the line most likely represent a moving area of interest. The only problem of course is figuring out which moving average to use!

# Summary: Moving Averages

- There are many types of moving averages. The two most common types are a simple moving average and an exponential moving average.
- Simple moving averages are the simplest form of moving averages, but they are susceptible to spikes.
- Exponential moving averages put more weight to recent price, which means they place more emphasis on what traders are doing now.

- It is much more important to know what traders are doing now than to see what they did last week or last month.
- Simple moving averages are smoother than exponential moving averages.
- Longer period moving averages are smoother than shorter period moving averages.
- Using the exponential moving average can help you spot a trend faster, but is prone to many fake outs.
- Smooth moving averages are slower to respond to price action but will save you from spikes and fake outs. However, because of their slow reaction, they can delay you from taking a trade and may cause you to miss some good opportunities.
- You can use moving averages to help you define the trend, when to enter, and when the trend is coming to an end.
- Moving averages can be used as dynamic support and resistance levels.
- One of the best ways to use moving averages is to plot different types so that you can see both long term movement and short term movement.

You got all of that? Why don't you open up your charting software and try popping up some moving averages.

Remember, using moving averages is easy. The hard part is determining which one to use!

That's why you should try them out and figure out which best fits your style of trading. Maybe you prefer a trend-following system. Or maybe you want use them as dynamic support and resistance.

Whatever you choose to do, make sure you read up and do some testing to see how it fits into your overall trading plan.

# Bollinger Bands

Congratulations on making it to the 5th grade! Each time you make it to the next grade you continue to add more and more tools to your trader's toolbox.

"What's a trader's toolbox?" you ask.

Simple!

Let's compare trading to building a house. You wouldn't use a hammer on a screw, right? Nor would you use a buzz saw to drive in nails. There's a proper tool for each situation.

Just like in trading, some trading tools and indicators are best used in particular environments or situations. So, the more tools you have, the better you can adapt to the ever changing market environment.

Or if you want to focus on a few specific trading environments or tools, that's cool too. It's good to have a specialist when installing your electricity or plumbing in a house, just like it's cool to be a Bollinger band or Moving Average expert.

There are a million different ways to grab some pips!

For this lesson, as you learn about these indicators, think of each as a new tool that you can add to that toolbox of yours.

You might not necessarily use all of these tools, but it's always nice to have plenty of options, right? You might even find one that you understand and comfortable enough to master on its own. Now, enough about tools already!

Let's get started!

## *Bollinger Bands*

Bollinger bands are used to measure a market's volatility.

Basically, this little tool tells us whether the market is quiet or whether the market is **LOUD**! When the market is quiet, the bands contract and when the market is **LOUD**, the bands expand.

Notice on the chart below that when price is quiet, the bands are close together. When price moves up, the bands spread apart.

That's all there is to it. Yes, we could go on and bore you by going into the history of the Bollinger band, how it is calculated, the mathematical formulas behind it, and so on and so forth, but we really didn't feel like typing it all out.

In all honesty, you don't need to know any of that junk. We think it's more important that we show you some ways you can apply the Bollinger bands to your trading.

Note: If you really want to learn about the calculations of a Bollinger band, then you can go to www.bollingerbands.com.

## *The Bollinger Bounce*

One thing you should know about Bollinger bands is that price tends to return to the middle of the bands. That is the whole idea behind the Bollinger bounce. By looking at the chart below, can you tell us where the price might go next?

If you said down, then you are correct! As you can see, the price settled back down towards the middle area of the bands.

What you just saw was a classic Bollinger bounce. The reason these bounces occur is because Bollinger bands act like dynamic support and resistance levels.

The longer the time frame you are in, the stronger these bands tend to be. Many traders have developed systems that thrive on these bounces and this strategy is best used when the market is **ranging** and there is no clear trend.

Now let's look at a way to use Bollinger bands when the market **does** trend.

## *Bollinger Squeeze*

The Bollinger squeeze is pretty self-explanatory. When the bands squeeze together, it usually means that a breakout is getting ready to happen.

If the candles start to break out above the top band, then the move will usually continue to go up. If the candles start to break out below the lower band, then price will usually continue to go down.

Looking at the chart above, you can see the bands squeezing together. The price has just started to break out of the top band. Based on this information, where do you think the price will go?

If you said up, you are correct again!

This is how a typical Bollinger squeeze works.

This strategy is designed for you to catch a move as early as possible. Setups like these don't occur every day, but you can probably spot them a few times a week if you are looking at a 15-minute chart.

There are many other things you can do with Bollinger bands, but these are the 2 most common strategies associated with them. It's time to put this in your trader's toolbox before we move on to the next indicator.

# Moving Average Convergence Divergence (MACD)

MACD is an acronym for **M**oving **A**verage **C**onvergence **D**ivergence. This tool is used to identify moving averages that are indicating a new trend, whether it's bullish or bearish. After all, our top priority in trading is being able to find a trend, because that is where the most money is made.

With an MACD chart, you will usually see three numbers that are used for its settings.

- The first is the number of periods that is used to calculate the faster moving average.
- The second is the number of periods that is used in the slower moving average.
- And the third is the number of bars that is used to calculate the moving average of the difference between the faster and slower moving averages.

For example, if you were to see "12, 26, 9" as the MACD parameters (which is usually the default setting for most charting packages), this is how you would interpret it:

- The 12 represents the previous 12 bars of the faster moving average.
- The 26 represents the previous 26 bars of the slower moving average.
- The 9 represents the previous 9 bars of the difference between the two moving averages. This is plotted by vertical lines called a histogram (the green lines in the chart above).

There is a common misconception when it comes to the lines of the MACD. The two lines that are drawn are NOT moving averages of the price. Instead, they are the moving averages of the **DIFFERENCE** between two moving averages.

In our example above, the faster moving average is the moving average of the difference between the 12 and 26-period moving averages. The slower moving average plots the average of the previous MACD line. Once again, from our example above, this would be a 9-period moving average.

This means that we are taking the average of the last 9 periods of the faster MACD line and plotting it as our slower moving average. This smoothens out the original line even more, which gives us a more accurate line.

The histogram simply plots the difference between the fast and slow moving average. If you look at our original chart, you can see that, as the two moving averages separate, the histogram gets bigger.

This is called divergence because the faster moving average is "diverging" or moving away from the slower moving average.

As the moving averages get closer to each other, the histogram gets smaller. This is called convergence because the faster moving average is "converging" or getting closer to the slower moving average.

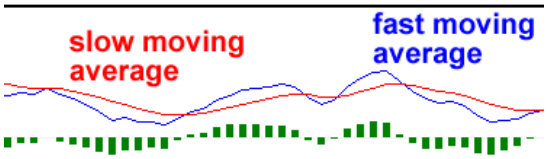
And that, my friend, is how you get the name, **M**oving **A**verage **C**onvergence **D**ivergence! Whew, we need to crack our knuckles after that one!

Ok, so now you know what MACD does. Now we'll show you what MACD can do for YOU.

## *How to Trade Using MACD*

Because there are two moving averages with different "speeds", the faster one will obviously be quicker to react to price movement than the slower one.

When a new trend occurs, the fast line will react first and eventually cross the slower line. When this "crossover" occurs, and the fast line starts to "diverge" or move away from the slower line, it often indicates that a new trend has formed.




From the chart above, you can see that the fast line crossed under the slow line and correctly identified a new downtrend. Notice that when the lines crossed, the histogram temporarily disappears.

This is because the difference between the lines at the time of the cross is 0. As the downtrend begins and the fast line diverges away from the slow line, the histogram gets bigger, which is good indication of a strong trend.

Let's take a look at an example.

In EUR/USD's 1-hour chart above, the fast line crossed above the slow line while the histogram disappeared. This suggested that the brief downtrend would eventually reverse.

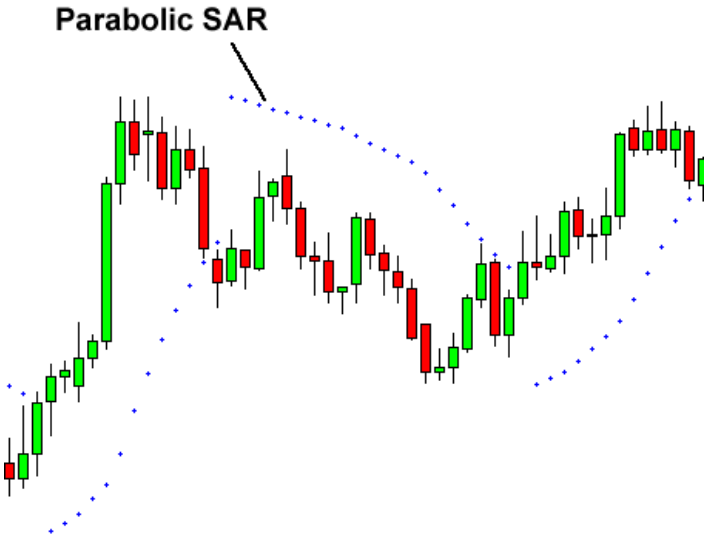
From then, EUR/USD began shooting up as it started a new uptrend. Imagine if you went long after the crossover, you would've gained almost 200 pips!

There is one drawback to MACD. Naturally, moving averages tend to lag behind price. After all, it's just an average of historical prices.

Since the MACD represents moving averages of **other** moving averages and is smoothed out by another moving average, you can imagine that there is quite a bit of lag. However, MACD is still one of the most favored tools by many traders.

# Parabolic SAR

Up until now, we've looked at indicators that mainly focus on catching the beginning of new trends. Although it is important to be able to identify new trends, it is equally important to be able to identify where a trend ends. After all, what good is a well-timed entry without a well-timed exit?




One indicator that can help us determine where a trend might be ending is the Parabolic SAR (**S**top **A**nd **R**eversal). A Parabolic SAR places dots, or points, on a chart that indicate potential reversals in price movement.

From the image above, you can see that the dots shift from being below the candles during the uptrend to above the candles when the trend reverses into a downtrend.

## *How to Trade Using Parabolic SAR*

The nice thing about the Parabolic SAR is that it is really simple to use. We mean REALLY simple.

Basically, when the dots are below the candles, it is a buy signal; and when the dots are above the candles, it is a sell signal.

Simple?

Yes, we thought so.

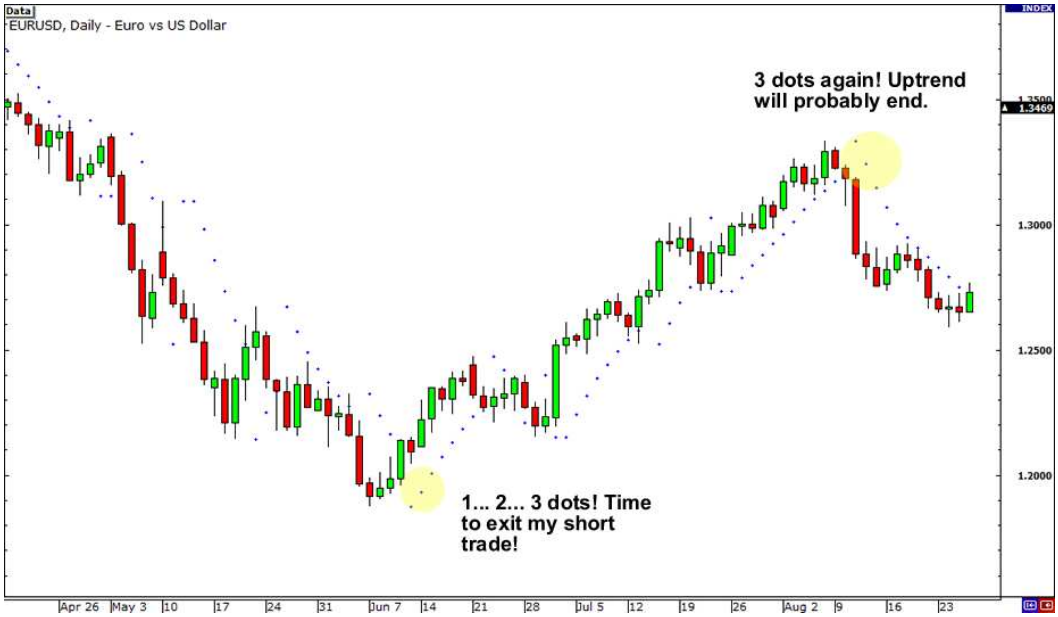
This is probably the easiest indicator to interpret because it assumes that the price is either going up or down. With that said, this tool is best used in markets that are trending, and that have long rallies and downturns.

You DON'T want to use this tool in a choppy market where the price movement is sideways.

## *Using Parabolic SAR to exit trades*

You can also use Parabolic SAR to help you determine whether you should close your trade or not.

Check out how the Parabolic SAR worked as an exit signal in EUR/USD's daily chart above.




When EUR/USD started sliding down in late April, it seemed like it would just keep droppin' like it's hot. A trader who was able to short this pair has probably wondered how low it can go.

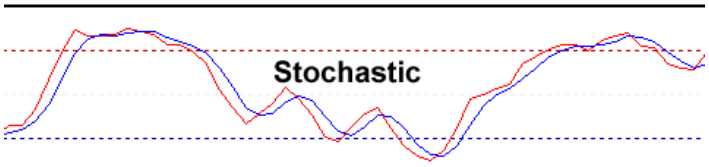
In early June, three dots formed at the bottom of the price, suggesting that the downtrend was over and that it was time to exit those shorts.

If you stubbornly decided to hold on to that trade thinking that EUR/USD would resume its drop, you would've probably erased all those winnings since the pair eventually climbed back near 1.3500.

# Stochastic

The Stochastic is another indicator that helps us determine where a trend might be ending.

By definition, a Stochastic is an oscillator that measures overbought and oversold conditions in the market. The 2 lines are similar to the MACD lines in the sense that one line is faster than the other.

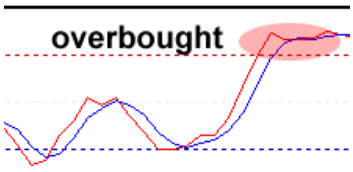



### *How to Trade Using the Stochastic*

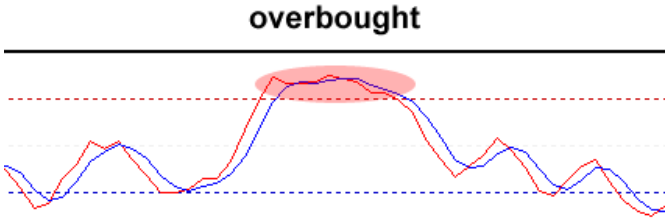
As we said earlier, the Stochastic tells us when the market is overbought or oversold. The Stochastic is scaled from 0 to 100.

When the Stochastic lines are above 80 (the red dotted line in the chart above), then it means the market is overbought. When the Stochastic lines are below 20 (the blue dotted line), then it means that the market is oversold.

As a rule of thumb, we buy when the market is oversold, and we sell when the market is overbought.




Looking at the chart above, you can see that the Stochastic has been showing overbought conditions for quite some time. Based on this information, can you guess where the price might go?



If you said the price would drop, then you are absolutely correct! Because the market was overbought for such a long period of time, a reversal was bound to happen.

That is the basics of the Stochastic. Many traders use the Stochastic in different ways, but the main purpose of the indicator is to show us where the market conditions could be overbought or oversold.

Over time, you will learn to use the Stochastic to fit your own personal trading style.

Okay, let's move on to RSI.

# Relative Strength Index

Relative Strength Index, or RSI, is similar to the stochastic in that it identifies overbought and oversold conditions in the market. It is also scaled from 0 to 100. Typically, readings below 30 indicate oversold, while readings over 70 indicate overbought.

### *How to Trade Using RSI*

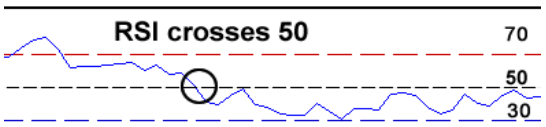
RSI can be used just like the stochastic. We can use it to pick potential tops and bottoms depending on whether the market is overbought or oversold.

Below is a 4-hour chart of EUR/USD.

## ***Determining the Trend using RSI***

RSI is a very popular tool because it can also be used to confirm trend formations. If you think a trend is forming, take a quick look at the RSI and look at whether it is above or below 50.

If you are looking at a possible uptrend, then make sure the RSI is above 50. If you are looking at a possible downtrend, then make sure the RSI is below 50.




In the beginning of the chart above, we can see that a possible downtrend was forming. To avoid fake outs, we can wait for RSI to cross below 50 to confirm our trend. Sure enough, as RSI passes below 50, it is a good confirmation that a downtrend has actually formed.

# Average Directional Index

The Average Directional Index, or ADX for short, is another example of an oscillator. It fluctuates from 0 to 100, with readings below 20 indicating a weak trend and readings above 50 signaling a strong trend.

Unlike the stochastic, ADX doesn't determine whether the trend is bullish or bearish. Rather, it merely measures the strength of the current trend. Because of that, ADX is typically used to identify whether the market is ranging or starting a new trend.

Take a look at these neat charts we've pulled up:

In this first example, ADX lingered below 20 from late September until early December. As you can see from the chart, EUR/CHF was stuck inside a range during that time. Beginning in January though, ADX started to climb above 50, signaling that a strong trend could be waiting in the wings.

And would you look at that! EUR/CHF broke below the bottom of the range and went on a strong downtrend. Ooh, that'd be around 400 pips in the bag.

Book it, baby!

Now, let's look at this next example:

Just like in our first example, ADX hovered below 20 for quite a while. At that time, EUR/CHF was also ranging. Soon enough, ADX rose above 50 and EUR/CHF broke above the top of its range.

Tada!

A strong uptrend took place. That'd be 300 pips, signed, sealed, and delivered!

Looks simple enough, right?

If there's one problem with using ADX, it's that it doesn't exactly tell you whether it's a buy or a sell. What it does tell you is whether it'd be okay to jump in an ongoing trend or not.

Once ADX starts dropping below 50 again, it could mean that the uptrend or downtrend is starting to weaken and that it might be a good time to lock in profits.

## *How to Trade Using ADX*

One way to trade using ADX is to wait for breakouts first before deciding to go long or short. ADX can be used as confirmation whether the pair could possibly continue in its current trend or not.

Another way is to combine ADX with another indicator, particularly one that identifies whether the pair is headed downwards or upwards.

ADX can also be used to determine when one should close a trade early.

For instance, when ADX starts to slide below 50, it indicates that the current trend is losing steam. From then, the pair could possibly move sideways, so you might want to lock in those pips before that happens.

# Ichimoku Kinko Hyo

Yes, you're still in the right place. You're still in the School of Pipsology and not in some Japanese pop fan girl site (although Huck may disagree with the rest of the FX-Men on that). No, "Ichimoku Kinko Hyo" ain't Japanese for "May the pips be with you," but it can help you grab those pips nonetheless.

Ichimoku Kinko Hyo (IKH) is an indicator that gauges future price momentum and determines future areas of support and resistance. Now that's 3-in-1 for y'all! Also know that this indicator is mainly used on JPY pairs.

To add to your Japanese vocab, the word *ichimoku* translates to "a glance", *kinko* means "equilibrium", while *hyo* is Japanese for "chart." Putting that all together, the phrase *ichimoku kinko hyo* stands for "a glance at a chart in equilibrium." Huh, what does all that mean?

A chart might make things easier to explain...

Whoops. That didn't help. A few more lines and this'll resemble a seismograph.

Before you go off and call this gibberish, let's try to find out what each of the lines is for.

**Kijun Sen** (blue line): Also called standard line or base line, this is calculated by averaging the highest high and the lowest low for the past 26 periods.

**Tenkan Sen** (red line): This is also known as the turning line and is derived by averaging the highest high and the lowest low for the past nine periods.

**Chikou Span** (green line): This is called the lagging line. It is today's closing price plotted 26 periods behind.

**Senkou Span** (orange lines): The first Senkou line is calculated by averaging the Tenkan Sen and the Kijun Sen and plotted 26 periods ahead. The second Senkou line is determined by averaging the highest high and the lowest low for the past 52 periods and plotted 26 periods ahead.

Got it? Well, it's not really necessary for you to memorize how each of the lines is computed. What's more important is for you to know how to interpret these fancy lines.

## *How to Trade Using Ichimoku Kinyo Hyo*

Let's take a look at the Senkou span first.

If the price is above the Senkou span, the top line serves as the first support level while the bottom line serves as the second support level.

If the price is below the Senkou span, the bottom line forms the first resistance level while the top line is the second resistance level. Got it?

Meanwhile, the Kijun Sen acts as an indicator of future price movement. If the price is higher than the blue line, it could continue to climb higher. If the price is below the blue line, it could keep dropping.

The Tenkan Sen is an indicator of the market trend. If the red line is moving up or down, it indicates that the market is trending. If it moves horizontally, it signals that the market is ranging.

Lastly, if the Chikou Span or the green line crosses the price in the bottom-up direction, that's a buy signal. If the green line crosses the price from the top-down, that's a sell signal.

Here's that line-filled chart once more, this time with the trade signals:

It sure looks complicated at first but this baby's got support and resistance levels, crossovers, oscillators, and trend indicators all in one go! Amazing, right?

Okey dokey, we've already covered a smorgasbord of indicators. Let's see how we can put all of what you just learned together...

# Putting It All Together

Now that you know how some of the most common chart indicators work, you're ready to get down and dirty with some examples. Better yet, let's combine some of these indicators and see how their trade signals pan out.

In a perfect world, we could take just one of these indicators and trade strictly by what that indicator told us. The problem is that we DON'T live in a perfect world, and each of these indicators has imperfections.

That is why many traders combine different indicators together so that they can "screen" each other. They might have 3 different indicators and they won't trade unless all 3 indicators give them the same signal.

In this first example, we've got the Bollinger bands and the Stochastic on EUR/USD's 4-hour chart. Since the market seems to be ranging or moving sideways, we'd better watch out for the Bollinger bounce.

EURUSD, 240 min - Euro vs US Dollar
price reached the top of of the band... Sell signal
price at the bottom of the band... Buy signal
stochastic is overbought... Sell signal
stochastic is oversold... Buy signal
Stochastic

Check out that those sell signals from the Bollinger bands and the Stochastic. EUR/USD climbed until the top of the band, which usually acts as a resistance level.

At the same time, the Stochastic reached the overbought area, suggesting that the price could drop down soon.

And what happened next?

EUR/USD fell by around 300 pips and you would've made a hefty profit if you took that short trade.

Later on, the price made contact with the bottom of the band, which usually serves as a support level. This means that the pair could bounce up from there. With the Stochastic in the oversold area, it means we should go long.

If you took that trade, you would have gotten around 400 pips! Not bad!

Here's another example, with the RSI and the MACD this time.

When the RSI reached the overbought area and gave a sell signal, the MACD soon followed with a downward crossover, which is also a sell signal. And, as you can see, the price did move downhill from there.

Hooray for our indicators!

Later on, the RSI dipped to the oversold region and gave a buy signal. A few hours after, the MACD made an upward crossover, which is also a buy signal. From there, the price made a steady climb. More pips for us, yipee!

You probably noticed in this example that the RSI gives signals ahead of the MACD. Because of the various properties and magic formulas for the technical indicators, some really do give early signals while others are a bit delayed.

You'll learn more about this in sixth grade.

As you continue your journey as a trader, you will discover which indicators work best for you. We can tell you that we like using MACD, the Stochastic, and RSI, but you might have a different preference.

Every trader out there has tried to find the "magic combination" of indicators that will give them the right signals all the time, but the truth is that there is no such thing.

We urge you to study each indicator on its own until you know the tendencies of how it behaves relative to price movement, and then come up with your own combination that **you** understand and that fits your trading style.

Later on in the course, we will show you an example of a system that combines different indicators to give you an idea of how they can complement each other.

# What is the Most Profitable Indicator?

Now on to the good stuff: Just how profitable is each indicator on its own?

After all, traders don't include these indicators just to make their charts look nicer. Traders are in the business of making money! If these indicators generate signals that don't translate to a profitable bottom line over time, then they're simply not the way to go for your needs!

In order to give y'all a comparison of the effectiveness of each indicator, we've decided to backtest each of the indicators on their own for the past 5 years. Backtesting, the expertise of our resident robot Robopip, involves retroactively testing the parameters of the indicators against historical price action. You'll learn more about this in your future studies.

For now, just take a look at the parameters we used for our backtest.

| Indicator | Parameters | Rules |
|---|---|---|
| | | Cover and go long when daily closing price crosses below lower band |
| Bollinger Bands | (30,2,2) | |
| | | Cover and go short when daily closing price crosses above upper band |
| | | Cover and go long when MACD1 (fast) crosses above MACD2 (slow) |
| MACD | (12,26,9) | |
| | | Cover and go short when MACD1 crosses below MACD2 |
| | | Cover and go long when daily closing price crosses above ParSAR |
| Parabolic SAR | (.02,.02,.2) | |
| | | Cover and go short when daily closing price crosses below ParSAR |
| | | Cover and go long when Stoch %K crosses above 20 |
| Stochastic | (14,3,3) | |
| | | Cover and go short when Stoch %K crosses below 80 |
| | | Cover and go long when RSI crosses above 30 |
| RSI | (9) | |
| | | Cover and go short when RSI crosses below 70 |
| | | Cover and go long when conversion line crosses above base line |
| Ichimoku Kinko Hyo | (9,26,52,1) | |
| | | Cover and go short when conversion line crosses below base line |

Using these parameters, we tested each of the indicators on its own on the daily time frame of EUR/USD over the past 5 years. We are trading 1 lot (that's 100,000 units) at a time with no set stop losses or take profit points. We simply cover and switch position once a new signal appears. This means if we initially had a long position then the

indicator told us to sell, we would cover, and establish a new short position. Also, we were assuming we were well capitalized (as suggested in our Leverage lesson) and started with an example balance of $100,000.

Aside from the actual profit and loss of each strategy, we included total pips gained/lost and the max drawdown.

Again, let us just remind you that we **DO NOT SUGGEST** trading without any stop losses. This is just for illustrative purposes only!

Moving on, here are the results of our backtest:

| Strategy | Number of Trades | P/L in Pips | P/L in % | Max Drawdown |
|---|---|---|---|---|
| BuyAndHold | 1 | -3,416.66 | -3.42 | 25.44 |
| Bollinger Bands | 20 | -19,535.97 | -19.54 | 37.99 |
| MACD | 110 | 3,937.67 | 3.94 | 27.55 |
| Parabolic SAR | 128 | -9,746.29 | -9.75 | 21.96 |
| Stochastic | 74 | -20,716.40 | -20.72 | 30.64 |
| RSI | 8 | -18,716.69 | -18.72 | 34.57 |
| Ichimoku Kinko Hyo | 53 | 30,341.22 | 30.34 | 19.51 |

The data showed that over the past 5-years, the indicator that performed the best on its own was the Ichimoku Kinko Hyo indicator. It generated a total profit of $30,341, or 30.35%. Over 5 years, that gives us an average of just over 6% per year!

Surprisingly, the rest of the indicators were a lot less profitable, with the Stochastic indicator showing a return of just 20.72%. Furthermore, all of the indicators led to substantial drawdowns of between 20% to 30%.

However, this does not mean that the Ichimoku Kinko Hyo indicator is the best or that indicators as a whole are useless.

Rather, this just goes to show that they aren't that useful on their own.

Think of all those martial arts movies you watched growing up. Aside from The Rock and the People's Elbow, no one relied on just one move to beat all the bad guys. Each of them used a combination of moves to get the job done.

Trading is similar. It is an art and as traders, we need to learn how to use and combine the tools at hand in order to come up with a system that works for us.

This brings us to our next lesson: putting all these indicators together!

# Summary: Common Chart Indicators

Everything you learn about trading is like a tool that is being added to your trader's toolbox. Your tools will give you a better chance of making good trading decisions when you use the right tool at the right time.

## *Bollinger Bands.*

- Used to measure the market's volatility.
- They act like mini support and resistance levels.

### Bollinger Bounce

- A strategy that relies on the notion that price tends to always return to the middle of the Bollinger bands.
- You buy when the price hits the lower Bollinger band.
- You sell when the price hits the upper Bollinger band.
- Best used in ranging markets.

### Bollinger Squeeze

- A strategy that is used to catch breakouts early.
- When the Bollinger bands "squeeze", it means that the market is very quiet, and a breakout is eminent. Once a breakout occurs, we enter a trade on whatever side the price makes its breakout.

## *MACD*

- Used to catch trends early and can also help us spot trend reversals.
- It consists of 2 moving averages (1 fast, 1 slow) and vertical lines called a histogram, which measures the distance between the 2 moving averages.
- Contrary to what many people think, the moving average lines are NOT moving averages of the price. They are moving averages of other moving averages.
- MACD's downfall is its lag because it uses so many moving averages.
- One way to use MACD is to wait for the fast line to "cross over" or "cross under" the slow line and enter the trade accordingly because it signals a new trend.

## *Parabolic SAR*

- This indicator is made to spot trend reversals, hence the name Parabolic Stop And Reversal (SAR).
- This is the easiest indicator to interpret because it only gives bullish and bearish signals.
- When the dots are above the candles, it is a sell signal.
- When the dots are below the candles, it is a buy signal.
- These are best used in trending markets that consist of long rallies and downturns.

### *Stochastic*

- Used to indicate overbought and oversold conditions.
- When the moving average lines are above 80, it means that the market is overbought and we should look to sell.

When the moving average lines are below 20, it means that the market is oversold and we should look to buy.

### *Relative Strength Index (RSI)*

- Similar to the stochastic in that it indicates overbought and oversold conditions.
- When RSI is above 70, it means that the market is overbought and we should look to sell.
- When RSI is below 30, it means that the market is oversold and we should look to buy.
- RSI can also be used to confirm trend formations. If you think a trend is forming, wait for RSI to go above or below 50 (depending on if you're looking at an uptrend or downtrend) before you enter a trade.

### *Average Directional Index (ADX)*

- The ADX measures how strong a trend is.
- It fluctuates from 0 to 100, with readings below 20 indicating a weak trend and readings above 50 signaling a strong trend.
- ADX can be used as confirmation whether the pair could possibly continue in its current trend or not.
- ADX can also be used to determine when one should close a trade early. For instance, when ADX starts to slide below 50, it indicates that the current trend is losing steam.

### *Ichimoku Kinko Hyo*

- Ichimoku Kinko Hyo (IKH) is an indicator that gauges future price momentum and determines future areas of support and resistance.
- *Ichimoku* translates to "a glance", *kinko* means "equilibrium", while *hyo* is Japanese for "chart". Putting that all together, the phrase ichimoku kinko hyo stands for "a glance at a chart in equilibrium."
- If the price is above the Senkou span, the top line serves as the first support level while the bottom line serves as the second support level. If the price is below the Senkou span, the bottom line forms the first resistance level while the top line is the second resistance level.
- The Kijun Sen acts as an indicator of future price movement. If the price is higher than the blue line, it could continue to climb higher. If the price is below the blue line, it could keep dropping.

- The Tenkan Sen is an indicator of the market trend. If the red line is moving up or down, it indicates that the market is trending. If it moves horizontally, it signals that the market is ranging.
- The Chikou Span is the lagging line. If the Chikou line crosses the price in the bottom-up direction, that's a buy signal. If the green line crosses the price from the top-down, that's a sell signal.

Each indicator has its imperfections. This is why traders combine many different indicators to "screen" each other. As you progress through your trading career, you will learn which indicators you like the best and can combine them in a way that fits **your** trading style.

Forex Tester 2
File Edit View Insert Orders Testing Tools Window Help
History Mode
Start Test
Timeframe:
15 mins
Every tick
Market Info
Symbol Bid Ask S
Currency Tick chart Stats
Data
Parameter Value
EURUSD, M15
Date 2008.10.31
Time 05:45
Open 1.2847
High 1.2867
Low 1.2796
Close 1.2796
Volume 60
Bar index 65
Ishimoku (9, 26, 52)
Tenkan Sen 1.2835
Kijun Sen 1.2820
Chinkou Span 1.2796
Senkou Span A 1.2827
Senkou Span B 1.2870
EURUSD, M15
EURUSD, M15, cell: 55, scale: 100%
18 / 114 / 1.2860
EURUSD, M1
EURUSD, M1, cell: 10, scale: 100%
Stochastic (8, 3, 3, High/Low)
AUDUSD, H1
AUDUSD, H1, cell: 460, scale: 100%
Bulls Power (13)
USDJPY, M1
USDJPY, M1, cell: 10, scale: 100%
USDJPY, M1 EURUSD, M1 EURUSD, M15 AUDUSD, H1
Ticket Symbol Type Lots Open Time Open Price S/L T/P Market Price Comm Swap Points Profit
Balance: 0.00 Equity: 0.00 Margin: 0.00 Free margin: 0.00 Margin level: 0.00%
0.00
Open Positions [ 0 ] Pending Orders [ 0 ] Account History Journal
2008.10.31 05:45 O: 1.2847 H:1.2867 L: 1.2796 C: 1.2796 V: 60

If you not have any Trading Account?

If you want to start Forex Trading as you career?

If you want to have forex as source of income?

If you want to get benefit of Forex Industry?

This site is for you…..

## Automatic Robot Forex Trading, Un limit profit ,No experience,

NO More Loss in Forex Trading

Keep working while you are sleeping

Excellent Option

LOt of robot available but its really unique

**The Auto Profit Robot Features –**
**1.No trading experience required at all.**
**2.Works on metatrader 4 platform.**
**3. Buy , Sell & Pending orders real time on your trading chart.**
**4. Upto 300 percent profit in every month.**
**5. The robot will enter the trade & exit with profit.**
**6. 90 + % winning trades.**
**7. Works 24hours at any time without you and your pc or laptop .**
**8.Works with all major currency pairs.**
**9. Stop loss & Take profit take any time automatically.**
**10. Easy to use, you won't need any technical, fundamental, Or any forex knowledge.**

**U can start ur own business wid low investment and u are the king of ur business.**
**For more detail & Live Demo of Auto Profit robot**

## { Cost – 45 US dollars.} .

Its really amazing

**Skype ID – shahid.mycco**

**email yousaf.shahid@gmail.com**

Trading robot Auto-Profit is fully automatic and has a high yield and productivity. Despite its high level of profitability, the system has reduced risks. Advisor (robot trading system) Auto-Profit is the latest version of the most stable and trusted adviser time for a profitable multi-currency trading in the forex market. An expert can use both to trade any of the available tools of the trade (currency pairs, CFD, metals, etc.)

The benefit of the adviser is fully analyzing the current state of the market and make informed decisions, where b is not the price has gone.

Auto-Profit easily adapts to any currency pair and works perfectly for all time periods. In the process, Adviser monitors the open foreign exchange position for each currency to minimize foreign exchange risks. Due to the fact that trade is conducted in several directions, the adviser does not fixate on one accompanied by an open position and opens the parallel position on other instruments, thus compensating for the risks and reducing the possibility of a large almost to zero drawdown. Advisor is not a "Pipsovschik," and his work has no claims on the part of any of the well-known brokers.

Since the EA trades at once in both directions, its profitability in times greater than the profitability of their predecessors.

Auto-Profit Advisor is a new generation, are not to be restricted to trade only with one or more currency pairs, and use the full potential of the market and the whole range of possible tools of the trade!

The main advantages of Auto-profit 2.1 over previous versions :An updated analysis of the logic of using trading volume of all transactions, the market expects an imbalance of lots and allows it to trade. Has the function of monitoring a minimum level of free capital account, which increases the stability of the adviser to the long-term trend movements. In the Auto profit v.2.1 laid down the same principle of trade, and the Auto profit v.2.0, but the new version has a number of significant amendments to the trading algorithm and expanded a number of options available to the user for possible changes:

1. This version introduced the parameter Exit_mode - specifies the mode of the program, it may be an ordinary trade regime, or mode of Exit - exit the market in which the Adviser, in its closing order logic, more they will not open until you he does not allow it. The function is useful when planning to stop the adviser, for example, to remove the profit.

2. It is possible to install a fixed initial sales lot.

3. program does not use the pending orders.

4. We use virtual trading levels of the grid (marked horizon. lines on the chart), with achievement of which the program is making in its inherent logic of the action.

5. algorithm consists of three logical parts: - the basic logic - when net sales are normal. - support - when the error condition occurs, it closes the warrants using the average over the volume with the total trading results or trallingstopa grid to normal. - trade only BUY / SELL - Control logic - ensures that while the core logic (TS standard) for all orders was put TP or SL.

6. program can trade in three layers, the inclusion of each additional layer depends on the number of orders of the previous layer, or layer is directly connected as a "compensator"

imbalance of trade in the previous layer - the protective function - relationship is set in the properties.

7. Distance to install the following order (hSetky) may be dependent on the number of orders can uvlichivatsya or decrease, be constant.

8. Program continues to trade in any situation, for it is not afraid of interruptions in connection with the server broker, gaps, turn off the terminal and other abnormal situations. After turning the program recognizes their orders and, as applied to trade virtual levels, there is an auxiliary logic of the program over time, she recovered to work normally.

9. All dependencies and parameters of the program the user can modify its properties in the manual describes each parameter of the program. There is a selection of OE files.

10. program analyzes the imbalance of trade items each layer separately, and the overall imbalance of orders, depending on the trade that can be sent for each layer of the trade that would secure the trade.

11. program uses analysis of the available funds account, comparing it with the control level. And if the available funds are less dangerous border, you can specify in the settings, the adviser is blocking layer is the most dangerous trade, and continues to work less bulky. This allows you to increase the trading price range adviser.

# What have to do

**Step 1.**

Make your forex account free on following site

**http://pak.ifxworld.com/en/**

**Step 2**

Make deposit of 130 USD in ur above account of forex. You automatically will get 30% of your bonus credited in ur account.

**Step 3.**

Please pay us consultancy fee 45 USD to us we shall guide you through all process and set robot for you. A way toward your Financial Freedome.

skype Shahid.mycco

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## Cheapest Forex Robot

## High Yield Profit Robot

# http://pak.ifxworld.com